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INVENTORY AND ACCOUNTS RECEIVABLE FINANCING: THE MARYLAND MAZE

By SHALE D. STILLER*

"Neither a borrower nor a lender be." If everyone followed this advice given by Polonius to his son Laertes, there would be no need for this article. However, borrowing and lending money have become indispensable to the success of the modern commercial community.

Business men often find that they need additional working capital. The dictates of competition may force them to expand their plants or to broaden the range of their inventories. They seldom have available cash with which to finance these projects. They must continually pay higher wages and taxes. Their sales receipts are sporadic because of the frequent lack of diligence in prompt payment of bills.

Where can the business man obtain additional capital? The issuance of new stock (if the business is a corporation) may not be desirable because it will dilute the interest of the present owners. The normal procedure is to make a solemn request for a loan from a lending institution such as a bank or finance company. To mitigate the credit risk, the lender will of course require some kind of collateral. Usually the prospective borrower has no unencumbered assets that will serve as collateral except for his inventory and accounts receivable.

Can the lender obtain a valid security interest¹ in either inventory or accounts receivable? The function of this article is to describe the legal ramifications of this problem. An attempt has been made to cite all the relevant Maryland cases and statutes so that a few lawyers might be spared the

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¹ The term "valid security interest" refers to that type of interest which will entitle the lender to priority ahead of the borrower's other creditors if the borrower becomes bankrupt or insolvent. Bankruptcy and insolvency must always be considered, for without them there would be no need for security.

terrifying journey through the dark and obscure jungle of Maryland law in this field.²

This is not a "business man's" article — it is purely and simply a description of *legal* devices which presently serve as vehicles for lending on the security of accounts receivable and inventory. The analysis of accounts receivable financing will be devoted almost entirely to the prevalent system of "non-notification" financing, although some mention will also be made of the "factoring" of accounts receivable. The section on inventory financing will include a study of trust receipts, warehousing, factor's liens, and very briefly, pledges and chattel mortgages.

ACCOUNTS RECEIVABLE FINANCING

Financing on the security of accounts receivable is a comparatively recent practice. Possessing none of the ancient lineage of inventory financing, accounts receivable financing has nevertheless become a paramount means of securing loans to merchants and manufacturers.³ For many lenders, the fact that accounts receivable possess a greater degree of liquidity than inventory has been an important reason for this development. In addition, the complexity and confusion surrounding the legal devices used in inventory financing has made the relative simplicity of accounts receivable financing a great attraction.

Generally, there are two types of accounts receivable financing.⁴ One is called "factoring". Here a "factor" purchases the borrower's accounts receivable, assumes all credit risks, and notifies the account debtor to pay directly

² The novice in this area is usually bewildered by the difficulties of researching. For instance, the Maryland Digest includes such headings as blasphemy, census, disorderly houses, dueling, embracery, ferries, indians, livery stable keepers, and piracy — but to the author it offers totally inadequate, incomplete, and misleading guidance on the problems to be considered herein.

³ On accounts receivable financing, see SAULNIER AND JACOBY, *ACCOUNTS RECEIVABLE FINANCING* (1943); Livingston, *Assignment of Accounts Receivable*, 42 Ill. B. J. 773 (Supp., June, 1954); Burman, *Practical Aspects of Inventory and Receivables Financing*, 13 Law and Contemp. Prob. 555 (1948); Koch, *Economic Aspects of Inventory and Receivables Financing*, 13 *id.* 566, 574; Silverman, *Factoring: Its Legal Aspects and Economic Justification*, 13 *id.* at 593; Lauchheimer, *Some Problems of Modern Collateral Banking*, 26 Col. L. Rev. 129 (1926) (an early but good discussion); Comment, *Accounts Receivable as Collateral Security*, 44 Yale L. J. 639 (1935); Comment, *Multistate Accounts Receivable Financing: Conflicts in Context*, 67 Yale L. J. 402 (1958); Comment, *Contract Rights as Commercial Security: Present and Future Intangibles*, 67 Yale L. J. 847 (1958).

⁴ There are minor variations, but almost all financing of accounts receivable falls into one of the two categories described in the text.

to him.⁵ The other is usually referred to as "non-notification" financing. Here a financier makes loans on the security of *assigned* accounts receivable without assuming any credit risks and without notifying the assignor's customers, the account debtors. Non-notification financing is more prevalent because the borrower will not want the people who deal with him to realize that he is in "hock" to a finance company.⁶ Although it may be true that the prejudice against "hocking accounts" is disappearing, its secrecy still remains one of the important features of non-notification financing.⁷

Non-notification also pleases the financier since he will not have to assume the credit risks. The factor who purchases accounts receivable assumes all credit risks and must go through the expensive jobs of making credit investigations and collecting the accounts. The non-notifying financier does not assume these credit risks (the assignor guaranteeing payment of the accounts) and does not make the actual collections from the account debtors.

1. *The Legal Problem Of Notice*

Practically all the legal problems of accounts receivable financing stem from the more prevalent non-notification method.⁸ Chief among these problems is the validity of the assignment as against a subsequent assignee of the same account. If the borrower assigns the same account first to Bank A and then to Bank B, one of these banks obviously will not be able to collect the proceeds. Which one prevails? The rule originally adopted in Maryland seemed to be that the assignee who first gave notice of his claim to the debtor was preferred.⁹ This doctrine, of course, was an anathema to the non-notifying lenders, for their claims could always be cut off by a subsequent assignee who gave notice to the

⁵ In addition to the articles cited in n. 3, see Kelly, *Modern Factoring and How it Meets Today's New Financial Requirements*, 42 A. B. A. J. 13 (1956) (describing and extolling the virtues of factoring).

⁶ "The usefulness of the whole scheme, from the viewpoint of the borrower, rests upon the fact that the finance company does not notify the customers of the assignment, but allows the borrower as its agent to collect the accounts receivable and turn over to it the monies received by the borrower from his customers."

Lauchheimer, *supra*, n. 3, 130.

⁷ The earliest Maryland case on non-notification financing is *McGill v. Commercial Credit Co.*, 243 F. 637 (D. Md., 1917). Judge Rose's opinion provides an interesting description of the methods used to preserve the veil of secrecy.

⁸ "If the financing of accounts receivable were limited to orthodox factoring, we would have very little to discuss here that would be of interest to a practicing lawyer." Livingston, *supra*, n. 3, 776.

⁹ If he had actual notice of the prior assignment, he was *not* preferred.

account debtor.¹⁰ The theory behind this rule was that by failure to give notice, the first assignee enabled the owner of the account to commit a fraud by making another assignment. It was also felt that this doctrine protected bona fide purchasers from prior assignments and therefore facilitated commerce.¹¹

What was the status of the assignee's claim if the assignor went into bankruptcy? The attack by the trustee in bankruptcy was usually based on Section 60 of the Bankruptcy Act, the voidable preference section.¹² The purpose of allowing a trustee in bankruptcy to attack certain preferences was to prevent a failing debtor from paying off one or more of his creditors on the eve of bankruptcy. Without Section 60, relatives and other "insiders" would be given unfair advantage over the bankrupt's other creditors. To meet this problem, the preference section of the Bankruptcy Act has always allowed the trustee to recover transfers (i) for an antecedent debt, (ii) made within four

¹⁰ See *Lambert v. Morgan*, 110 Md. 1, 72 A. 407 (1909), involving a contest between successive mortgagees (treated as assignees) of the same beneficial interest in a trust. The Court of Appeals held that the first mortgagee (assignee) to give notice to the trustee prevailed over the other mortgagees. This doctrine originated in the famous English case, *Dearle v. Hall*, 3 Russ. Ch. 1, 38 Eng. Rep. 475 (1827). The rule in other states, and the federal common law rule, *Salem Co. v. Manufacturers' Co.*, 264 U. S. 182 (1924), was that among successive assignees the one prior in time prevailed, irrespective of notice.

¹¹ See Page, *Latent Equities in Maryland*, 1 Md. L. Rev. 1, 24 (1936). "[T]he effect of the rule is still in some doubt." There was apparently a different rule with respect to assignee of real estate mortgages. *Byles v. Tome*, 39 Md. 461 (1874). But see *Morrow v. Stanley*, 119 Md. 590, 87 A. 484 (1913). The rule was also slightly different when the dispute concerned the rights of an assignee and a creditor of the assignor who had garnished the debt in the hands of the account debtor. Since the creditor stood in the shoes of the assignor, it was felt that he was bound by the assignor's knowledge of the assignment. Therefore the assignee was not required to give notice to the account debtor in order to perfect his claim against the creditor. *Hohman v. Orem*, 169 Md. 634, 182 A. 587 (1936); *Baust v. Commonwealth Bank*, 158 Md. 280, 148 A. 236 (1930); *McDowell, Pyle & Co. v. Hopfield*, 148 Md. 84, 123 A. 742 (1925); *Brady v. State*, 26 Md. 290 (1867). *A fortiori*, where the assignee does give notice to the account debtor, he will prevail over a creditor who garnishes the debt, *Pen Mar Co. v. Ashman*, 152 Md. 273, 136 A. 640 (1927). See also *Seymour v. Finance & Guaranty Co.*, 155 Md. 514, 142 A. 710 (1928), and discussion by Page, *supra*, 19-24. A more realistic explanation than the "standing in the shoes" theory was the following: since the assignment was valid between the parties, the assignor had no interest upon which the lien of a creditor could attach; therefore even without notification the assignee prevailed over the creditor. It is interesting to note that in *In re Seim Const. Co.*, 37 F. Supp. 855 (D. Md., 1941), the court mistakenly assumes that a lien creditor of the assignor could prevail over the assignee.

¹² 11 U. S. C. A. §96 (1943). §70(c), 11 U. S. C. A. §110(c) (1953), the strong-arm clause, is of little use to the trustee in bankruptcy in this situation; under this section he possesses only the rights of a lien creditor, and in Maryland, the assignee prevailed over lien creditors regardless of whether or not he gave notice to the account debtor. *Supra*, n. 11.

months prior to bankruptcy, (iii) while the debtor was insolvent, and (iv) to a creditor who had reasonable cause to believe the debtor was insolvent.

Consider the following example: On January 1, Bank lends \$5,000 to Borrower who assigns to the Bank accounts receivable due from Account Debtor. The Bank does not notify the Account Debtor. On July 1, the Bank hears of Borrower's financial difficulties and notifies the Account Debtor of the assignment. On July 5, Borrower goes into bankruptcy. The trustee attempts to set aside the assignment as a preference. The issue is: *when* did the Borrower transfer the accounts to the Bank? If the date of transfer was January 1, it is not susceptible to attack as a preference because it was for a concurrent rather than an antecedent debt and did not occur within four months of bankruptcy. On the other hand, if the date of transfer was July 1, the assignment was obviously for an antecedent debt and within four months of bankruptcy.

Before 1938, the Bank had a relatively good chance of keeping the assigned account. The date of transfer was generally considered to be January 1, the date of the assignment, and not July 1, the date notice was given to the Account Debtor. The rule of "relation back" transported the effective date of the transfer to the date the assignment was executed. From the original agreement, the Bank received an "equitable lien" or "equitable assignment" which constituted a sufficient transfer for the purpose of Section 60.¹³

The 1938 Chandler Amendments to the Bankruptcy Act were designed in part to alter the above results. Inserted into Section 60(a) was the following language:

"... a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, . . ."^{13a}

With this amendment, will the time of the transfer be January 1 or July 1? The answer is July 1. This will make the

¹³ 11 U. S. C. A. §96 (1943), Historical Note, p. 611. See *In re Bresnan*, 45 F. 2d 193 (D. Md., 1930). Important Supreme Court cases, though not dealing with accounts receivable, were *Martin v. Commercial National Bank*, 245 U. S. 513 (1918); *Carey v. Donohue*, 240 U. S. 430 (1916); *Bailey v. Baker Ice Machine Co.*, 239 U. S. 268 (1915); *Sexton v. Kessler*, 225 U. S. 90 (1912).

^{13a} 11 U. S. C. A. §96(a) (1943).

transfer on account of an antecedent debt, within four months of the date of bankruptcy, and hence subject to attack as a voidable preference. The reasoning runs as follows: A transfer is deemed to have been made at the time when it becomes good against bona fide purchasers. Since under Maryland law, notice to the account debtor is necessary to preclude a subsequent bona fide purchaser of account from acquiring a superior equity, the transfer is not perfected until such notice is given. In our example, the account debtor was not notified until July 1, and the assignment is therefore considered as having been made on July 1. The loan of \$5,000 becomes a past consideration when viewed as of July 1, and the transfer (i.e., the notice which perfected the transfer) is "on account of an antecedent debt". Moreover, since the transfer is deemed to have occurred on July 1, it occurred within four months of bankruptcy.

The effect of this amendment to Section 60 was to invalidate the claims of every Maryland assignee who either notified the account debtor within the four month period, or else never notified the debtor at all, if it could be shown that the assignee had reason to believe the debtor was insolvent. The case of *In re Seim Const. Co.*¹⁴ demonstrated the fate of non-notification financing in Maryland. More than four months before its bankruptcy, the Seim Construction Co. assigned to Green part of a fund to arise in the future under an existing contract. No notice was given the account debtor until within four months of bankruptcy. Green asserted the right to collect the sum assigned. Judge Chesnut held that the assignment was a voidable preference since, under Maryland law, a bona fide purchaser from Seim could have acquired rights superior to Green's.¹⁵

Although this case represented a great setback to the Maryland financial institutions,¹⁶ the atmosphere was not wholly bleak. A rather curious decision by the Fourth Circuit, with the help of devious statutory construction, limited the emasculating effect of the Chandler Act on non-notifica-

¹⁴ 37 F. Supp. 855 (D. Md., 1941).

¹⁵ "... I think it fairly clear, under the Maryland decisions that a bona fide purchaser of this prospective fund from the bankrupt, ... could have secured a superior equity in the fund by giving notice ... prior to notice given by the claimant as first assignee." *Ibid.*, 858.

¹⁶ The writer of a Book Review in 4 Md. L. Rev. 431, 434 (1940), prophesied that "this result will cripple account financing by banks and credit companies." See also Judge Chesnut's remarks in *In re Seim Construction Co.*, *supra*, n. 14, 859.

tion financing. In *Associated Seed Growers v. Geib*,¹⁷ the old "equitable lien" and "relation back" doctrines were revived. This was a very complicated case involving assignments of present and future accounts receivable. The District Court and the Circuit Court both treated the original passing of consideration and the subsequent perfecting of the transfer as contemporaneous.¹⁸ In other words, the Court construed the first sentence of Section 60(a), providing that a preference is a transfer on account of an antecedent debt, as referring to the whole transaction and not simply to the steps to be taken to make it binding as to bona fide purchasers.¹⁹ Since the transfer was not on account of an antecedent debt, there was no depletion of the bankrupt's estate and no violation of the voidable preference rules. But there were two difficulties with this decision. First, it disregarded the express purpose of the Chandler Act, and second it relied on a case based on pre-1938 law.²⁰

Confusion and chaos reigned in banking circles. Finally, nine months after *Associated Seed Growers v. Geib*, the Supreme Court granted certiorari in a similar case that had arisen in the Third Circuit.²¹ On February 2 and 3, 1943, the Supreme Court heard arguments and a month later it rendered the bombshell known as *Corn Exchange Bank v. Klauder*.²² In this case a bank had taken an assignment of accounts receivable without giving notice to the debtors, even though Pennsylvania, whose law was controlling, required notification to the debtor (the same as Maryland). In a contest between the bank and the assignor's trustee in bankruptcy, the court held that because of the lack of notification it would have been possible for a hypothetical bona fide purchaser to acquire a right superior to that of the bank. Therefore the trustee, given the rights of such a purchaser by Section 60(a), could invalidate the assignment.

¹⁷ 125 F. 2d 683 (4th Cir., 1942) *revng.* In re Talbot Canning Corporation, 35 F. 680 (D. Md., 1940).

¹⁸ The Fourth Circuit based its reversal on other grounds.

¹⁹ See also *Adams v. City Bank & Trust Co.*, 115 F. 2d 453 (5th Cir., 1940).

²⁰ This case was *Union Trust Co. of Maryland v. Townsend*, 101 F. 2d 903 (4th Cir., 1939), *cert. den.*, 307 U. S. 646 (1939). Although it was decided in 1939, the facts arose before the Chandler Act and hence pre-1938 law was controlling. As late as 1949, one court erroneously relied on this case. *Ihle v. John L. Wasey, Inc.*, 81 F. Supp. 601 (W. D. La., 1949).

²¹ In re Quaker City Sheet Metal Co., 129 F. 2d 894 (3d Cir., 1942), *cert. granted*, 317 U. S. 617 (1942).

²² 318 U. S. 434 (1943) (7-1 opinion delivered by Mr. Justice Jackson).

With reference to Section 60(a), the Supreme Court said:

"Its apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state law would enforce against a good-faith purchaser. Only when such a purchaser is precluded from obtaining superior rights is the trustee so precluded. So long as the transaction is left open to possible intervening rights to such a purchaser, it is vulnerable to the intervening bankruptcy. By thus postponing the effective time of the transfer, the debt, which is effective when actually made, will be made antecedent to the delayed effective date of the transfer and therefore will be made a preferential transfer in law, although in fact made concurrently with the advance of money. In this case the transfers, good between the parties, had never been perfected as against good-faith purchasers by notice to the debtors as the law required, and so the conclusion follows from this reading of the Act that the petitioners lose their security under the preference prohibition of §60(b).

"Such a construction is capable of harsh results, and it is said that it will seriously hamper the business of 'non-notification financing', of which the present case is an instance. This business is of large magnitude and it is said to be of particular benefit to small and struggling borrowers. Such consequences may, as petitioners argue, be serious, but we find nothing in Congressional policy which warrants taking this case out of the letter of the Act."²³

The *Klauder* decision definitely overruled *Associated Seed Growers v. Geib*,²⁴ and firmly established the rule that all considerations affecting the preferential character of the transfer, including the "antecedent debt" factor, were to be judged as of the date when the transfer was perfected — or if it was not perfected prior to bankruptcy,

²³ *Ibid*, 436-38. For further discussion of the *Klauder* case and its effects, see Moore and Tone, *Proposed Bankruptcy Amendments: Improvement or Retrogression?* 57 Yale L. J. 683 (1948); Keefe, Kelly, and Lewis, *Sick Sixty: A Proposed Revision of Section 60A of the Bankruptcy Act*, 33 Corn. L. Q. 99 (1947); Koessler, *Assignment of Accounts Receivable: Confusion of the Present Law, The Impact of the Bankruptcy Act, and the Need for Uniform Legislation*, 33 Cal. L. Rev. 40 (1945).

²⁴ 125 F. 2d 683 (4th Cir., 1942). Mr. Justice Roberts, dissenting in *Klauder*, 318 U. S. 434 (1943), *dis. op.* 441, 442, cited *Associated Seed Growers v. Geib*.

then as if the transfer had been made immediately before the filing of the petition in bankruptcy.²⁵

Distress and consternation in Maryland financial circles became so acute that within two months a bill was introduced into the Maryland legislature to provide relief from the *Klauder* holocaust. On May 4, 1943, the following legislation was passed:

"All written assignments, and all written assignments in the nature of a pledge, of accounts receivable and amounts due or to become due on open accounts or contracts, except in cases where notice to the debtor of such assignment is specifically required by any policy of insurance or a statute then in effect, shall be valid and legal and shall pass the title of such accounts receivable and amounts due or to become due on open accounts or contracts to the assignee thereof, and shall take effect according to the terms of the assignment, *without the necessity of notice to the debtor*, and the transfer of the title shall take effect and be valid and enforceable against all persons as of the date thereof; . . ."²⁶

The manifest purpose of this statute was to make non-notification financing invulnerable to Section 60 of the Bankruptcy Act. The title of the assignee becomes valid against subsequent assignees even though notice is not given to the account debtor. No subsequent bona fide purchaser of the account would have rights superior to those of the first assignee, and since the trustee in bankruptcy possesses the rights of a hypothetical bona fide purchaser for purposes of Section 60, he cannot prevail over the first assignee.

Many other states passed statutes to protect non-notification financing.²⁷ This great wave of legislative activity culminated in the belated response of Congress in 1950 when Section 60 of the Bankruptcy Act was again amended.

²⁵ The "harsh results" predicted by the Supreme Court were soon forthcoming. Six months later, a district court in Missouri held that even though applicable state law might not require notification by an assignee to the account debtor, the trustee could nevertheless knock down the security. In re Vardaman Shoe Co., 52 F. Supp. 562 (D. Mo., 1943). The "harsh results", as we will see, also invalidated every trust receipt and factor's lien. See *infra*, ns. 95 and 149.

²⁶ MD. LAWS 1943, ch. 728 (emphasis added); 1 MD. CODE (1957), Art. 8, §1.

²⁷ See Koessler, *New Legislation Affecting Non-Notification Financing of Accounts Receivable*, 44 Mich. L. Rev. 563 (1946).

Substituted for the bona fide purchaser test was a lien creditor test (for property other than real property).²⁸ In other words, the trustee is placed in the shoes of a hypothetical lien creditor, whose powers are rarely as strong as those normally granted to a bona fide purchaser.²⁹ This amendment, however, did nothing to change the Maryland law on accounts receivable financing, for under both the bona fide purchaser and the lien creditor tests, the non-notifying assignee was firmly protected by the Act of 1943. The assignment is perfected against both purchasers and creditors at the time of its execution. Thus even without the 1950 Amendment, the assignment would not have been a preference in Maryland.³⁰

To give notice or not to give notice: that is the question. In the bankruptcy arena, the assignee no longer has to notify the account debtor. But are there other reasons why notice to the account debtor might be advisable? There are apparently at least three situations in Maryland where the assignee should give notice. The last line of the Act of 1943 provided that where the account debtor, in good faith and without knowledge of the assignment, pays his obligation to its original owner or to a subsequent assignee, the account debtor is discharged.³¹ Thus if the first assignee desires to avoid the trouble and expense of recovering the

²⁸ 11 U. S. C. A. §96(a) (2) (1957 Supp.). See Arnold, *The 1950 Amendment to the Preference Section of the Bankruptcy Act and Maryland Law*, 14 Md. L. Rev. 311 (1954).

²⁹ To prevent a recurrence of the "equitable lien" and "relation back" doctrines, §60(a) (6), 11 U. S. C. A. §96(a) (6) (1957), was inserted. The language is so incredibly complex that it must be seen to be believed.

³⁰ An interesting, though totally academic, question is whether non-notification financing would be valid in Maryland today *without* the Act of 1943, *supra*, n. 26. The issue would be: will a lien creditor of the assignor prevail over a non-notifying assignee. This writer thinks that Maryland cases favor the assignee — see cases cited, *supra*, n. 11, although Judge Chesnut, by dictum in the Seim case, 37 F. Supp. 855 (D. Md., 1941), apparently felt that the lien creditor would prevail. *Ibid.* The impotence of the 1950 Amendment to §60 [11 U. S. C. A. §96 (1957 Supp.)] is well described in a delightful article entitled "Much Ado About Nothing" which appeared a few months after the Congressional action. Conwill and Ellis, *Much Ado About Nothing: The Real Effect of Amended Section 60(a) on Accounts Receivable Financing*, 64 Harv. L. Rev. 62 (1950). Although it may be true that the 1950 Amendment was "much ado about nothing" in the accounts receivable field, it successfully allayed the fear that trust receipts and factors' liens were invalid. See *Coin Machine Acceptance Corp. v. O'Donnell*, 192 F. 2d 773 (4th Cir., 1951).

³¹ This probably is a restatement of pre-1943 law. See *Robinson v. Marshall*, 11 Md. 251 (1857) and *Shriner v. Lamborn*, 12 Md. 170 (1858). See also *dictum* in *McDowell, Powell & Co. v. Hopfield*, 148 Md. 84, 128 A. 742 (1925), to the effect that where a garnishee has already paid the debt to a creditor of the assignor, he cannot be forced to pay again to the assignee.

claim if it is paid to a subsequent assignee (assuming that he can), he should give notice to the debtor.³²

Second, how can the lender guard against the possibility of an earlier assignment? One way to prevent this double financing would be to ask the account debtor if there was a previous assignment. This will produce the desired information only where the prior assignee had notified the account debtor — a rare occurrence in a field which puts such a high price on secrecy. Reliance on the assignor's honesty is presumably the only way a financier can be certain that no prior assignees exist. Third, in a distressingly vague opinion in *Md. Coop. Milk Producers v. Bell*,³³ the Court of Appeals apparently held that if a debtor has received notice of the assignment, he cannot assert against the assignee a counterclaim that matured *after* notice of the assignment.³⁴ It must be remembered, of course, that the assignee, even though he is a purchaser for value, takes subject to all defenses and counterclaims that were available to the debtor against the assignor *before* the assignment.³⁵

Although these situations where notice might be advisable seldom arise, they are possibilities to be considered. Generally the desire for secrecy militates against notification, although the snobbish attitude of outsiders toward this type of financing is beginning to wane.

³² In some states it is expressly provided by statute that a second assignee collecting from the debtor is accountable to the first assignee. Is there any significance in the omission of this provision from the Maryland statute? Perhaps it implies that any assignee who collects an account in good faith is protected against prior assignees. This may encourage diligence in collecting accounts, which in turn will minimize fraud. See Comment, Craig, *Accounts Receivable Financing: A Reappraisal of Validation Statutes in the Light of Amended 60(a)*, 65 Harv. L. Rev. 627, 631-34 (1952).

³³ 206 Md. 168, 110 A. 2d 661 (1955).

³⁴ In this case, the Co-op made a loan to Unger to enable him to finance trucks and labor to be used in hauling for the Co-op. On June 8, Unger assigned to Bell his claim for hauling services rendered to the Co-op, payable on July 15. After this assignment, Unger defaulted on the loan, and on July 17, the Co-op credited against the loan the amount due from it to Unger on July 15. It was held that because Unger's default occurred before the Co-op received notice of the assignment, this set-off could be used against Bell's claim as assignee.

³⁵ *Farm. & Merch. Bk. v. Franklin Bk.*, 31 Md. 404 (1869). In *Cooke v. Real Estate Trust Co.*, 180 Md. 133, 22 A. 2d 554 (1941), an oil burner was sold with provision for return and money back if defective; it was held that the right of the seller's assignee is conditional on the excellence of the burner even though the buyer gave a negotiable note for the price which was transferred to the assignee. However, the doctrine of equitable estoppel may prevent a debtor from setting up defenses and counterclaims against the assignee. See *Securities Co. v. Trust Co.*, 136 Md. 417, 110 A. 860 (1920) and *Eversole v. Maull*, 50 Md. 95 (1878). In addition, the assignee takes free from latent equities of third parties (*i.e.*, parties other than the debtor). *Banking Co. v. Fid. & Dep. Co.*, 165 Md. 657, 170 A. 544, 171 A. 345 (1934). Page, *Latent Equities in Maryland*, 1 Md. L. Rev. 1, 10 (1936).

2. *The Problem Of Benedict v. Ratner*

Despite the major victory won by the banks and finance companies in the "battle of notice", they cannot sit back and watch the money roll in like the man who clips coupons. The law requires them to exercise a certain degree of supervision over the borrower-assignor. Just how much supervision they should exercise is a question that has never been successfully resolved.

In 1925, the Supreme Court handed down the famous decision of *Benedict v. Ratner*.³⁶ This case set forth the slippery rule that an assignment of accounts receivable will be fraudulent and void "as a matter of law" unless the assignee requires his borrower to account for all the proceeds of the assigned accounts and forbids him to divert these proceeds to his own use. To many lawyers this decision came as a great surprise. It was, of course, standard catechism that a chattel mortgage which reserved to the mortgagor the right to sell the collateral and dispose of the proceeds for his own uses was fraudulent and void.³⁷ It was thought that the basis of this rule was the ostensible or reputed ownership of the mortgagor; and since intangibles such as accounts receivable have no visible existence, theories of ostensible ownership were irrelevant in this field.

Faced with the task of finding a more justifiable conceptual peg on which it could invalidate an assignment with assignor in complete control of the proceeds, the Supreme Court, speaking through Mr. Justice Brandeis, said:

"But it is not true that the rule stated above and invoked by the receiver is either based upon or delimited by the doctrine of ostensible ownership. It rests not upon seeming ownership because of possession retained, but upon a lack of ownership because of dominion reserved. It does not raise a presumption of

³⁶ 268 U. S. 353 (1925).

³⁷ See *infra*, text at n. 74. *Edelhoff v. Horner-Miller Mfg. Co.*, 86 Md. 595, 39 A. 314 (1898); *In re Durham*, 114 F. 750 (D. Md., 1902); *Grimes v. Clark*, 234 F. 604 (4th Cir., 1916). Maryland extended the rule beyond the chattel mortgage. In *Price and Little v. Pitzer*, 44 Md. 521, 528 (1876), under a deed of trust the grantor remained in possession of his goods and premises without any effective restrictions on his conduct; the arrangement was void against creditors. "[N]o case has been provided to any Court in England, or this country, more grossly and clearly repugnant . . ." See also *Scott v. Keane*, 87 Md. 709, 40 A. 1070 (1898), where owner conveyed property to another but retained a life estate and most other powers of ownership including the power to dispose of the property without accounting for the proceeds. Held, the arrangement was fraudulent.

fraud. It imputes fraud conclusively because of the reservation of dominion inconsistent with the effective disposition of title and creation of a lien."³⁸

This case involved the Hub Carpet Company, a New York City mercantile concern, which had assigned all of its present and future accounts receivable to one Ratner. Although the receivables were to be collected by Hub, Ratner was given the rights (i) to demand at any time a full disclosure of the assignor's business and financial conditions, and (ii) to require that all amounts collected be applied in payment of his loans. But until he exercised his rights, Hub was neither required to apply any of the collections to the repayment of Ratner's loan, nor to replace accounts collected by other collateral of equal value, nor to account in any way to Ratner. Hub was essentially at total liberty to use the proceeds of all the accounts collected as it saw fit.

Clearly Hub had unrestricted dominion over the proceeds. "[T]he unfettered use by the company of the proceeds of the accounts precluded the effective creation of a lien and rendered the original assignment fraudulent in law."³⁹

"Unrestricted dominion" and "unfettered use" — these are the twin concepts which have unceasingly haunted the courts since 1925 in their struggle to demarcate the point at which the assignor's control will invalidate the assignment. Despite the experience of thirty years and countless decisions, the lines continue to waiver. The following paragraphs attempt to give some indication of the various factors which have influenced the courts in these cases.⁴⁰

³⁸ *Supra*, n. 36, 362-63. It has been complained that "this doctrine enunciated by the Supreme Court is just so much senseless verbiage". Cohen and Gerber, *Mortgages on Accounts Receivable*, 29 Geo. L. J. 555, 560 (1941).

³⁹ *Supra*, n. 36, 364-65.

⁴⁰ See Cohen and Gerber, *supra*, n. 38; *Comment, Accounts Receivable as Collateral Security*, 44 Yale L. J. 639 (1935); Note, 101 Univ. of Pa. L. Rev. 392 (1952); Note, 24 N. Y. U. L. Rev. 598 (1949). It has been suggested that the Uniform Fraudulent Conveyances Act, 4 Md. Code (1957), Art. 39B (Md. Laws 1920, Ch. 395), has changed the rule of *Benedict v. Ratner*. The Act had not been passed in New York when *Benedict v. Ratner* was decided. §7 of the Act provides that "[e]very conveyance made . . . with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud . . . creditors, is fraudulent as to . . . creditors". (Emphasis added.) "Conveyance" includes assignments, transfers, pledges, and mortgages; §1. Since the rule of *Benedict v. Ratner* is one of "constructive" rather than "actual" fraud, it is contended that this case has been overruled by the Act. However, the majority rule is that the Act does not cover cases of constructive fraud. See also §14 of the Act. The Statute has been ignored in all the Maryland cases, and in *In re Helfenbein*, 32 F. Supp.

When the accounts become due, the assignor collects the checks paid by the account debtors and, acting as agent or trustee for the assignee, he should either immediately turn them over to the assignee or else deposit them in a separate bank account in favor of the assignee. If he uses the proceeds in the conduct of his own business or if he mingles them with his other assets, the assignment will be vitiated. In *In re Helfenbein*,⁴¹ Judge Chesnut invalidated an arrangement whereby the Associated Credit Corporation, the assignee of the accounts, permitted the bankrupt-assignor to collect the accounts and deposit them in his general bank account and use them at will, so long as the assignor paid his current obligations on the loans made by the Credit Corporation.

"[T]he assignee must not intentionally or customarily permit the assignor . . . to collect and use the accounts without turning them over to the assignee to be credited on the indebtedness. If the assignor is so permitted to use the proceeds of the collections, it is considered as a matter of law that the arrangement between the parties is such that the assignor is allowed unfettered dominion and control over the accounts, despite the form of the assignment to the contrary; and in such a case the transaction is regarded as in fraud of creditors."⁴²

In an earlier case, *In re Saxon Coffee Co.*,⁴³ the bankrupt had never observed the agreement to pay the proceeds of the collections to the bank.

"The accounts were collected by the bankrupt, and the proceeds thereof were used by it in its business as freely as if the assignments had never been made. . . . [I]t was understood that the [assignee] would not interfere with the handling or use of the money by the Coffee Company."⁴⁴

26, 28 (D. Md., 1940), Judge Chesnut said that "[c]ases in this circuit do not seem to have considered the point and it was expressly discountenanced by the Second Circuit . . ."

⁴¹ 32 F. Supp. 26 (D. Md., 1940).

⁴² *Ibid.*, 27.

⁴³ 22 F. 2d 999 (D. Md., 1927).

⁴⁴ *Ibid.*, 999-1000. See also *Lone Star Cement Corporation v. Swartwout*, 93 F. 2d 767 (4th Cir., 1938); *In re Cummins Const. Corporation*, 81 F. Supp. 193, 199-200 (D. Md., 1948) (*dictum*). But see *Parker v. Meyer*, 37 F. 2d 556 (4th Cir., 1930), holding valid an arrangement where assignor collected the proceeds and used them freely, paying every sixty days an amount equal to his collections during that period. This decision has been criticized and should not be relied on. *In re Helfenbein*, 32 F. Supp. 26, 27 (D. Md., 1940).

A typical example of an invalid arrangement is illustrated in the recent Fourth Circuit decision of *Mount v. Norfolk Savings & Loan Corp.*⁴⁶ Here one Legum assigned about twenty-five percent of all his accounts to a savings and loan corporation. When Legum made his collections, he made no effort to segregate the assigned accounts but deposited all the checks in a national bank and used the proceeds in his business. The savings and loan corporation exercised no control over the collections and required no accountings from Legum. Occasionally, an agent of the assignee would check Legum's books to ascertain whether the open accounts were sufficient in amount to secure the loans, but there was no regularity to this procedure. Like every other merchant in this article, Legum went into bankruptcy, and Judge Soper had no difficulty in invalidating the assignment.

"[I]t is clear that Legum's control of the accounts assigned as collateral was substantially unrestricted and free. The occasional inspection of its ledgers and the occasional substitution of new accounts for old ones did not materially affect the situation, since each substitution merely replaced one invalid assignment by another equally defective without interfering with the free use by Legum of the moneys collected and the goods returned. Nor was the situation altered by the physical retention by the bank of the assigned contracts, for that circumstance could not interfere with Legum's control over collections . . . and actually did not interfere at all with Legum's operations."⁴⁶

The substitution of new accounts for old ones and the problems of returned goods mentioned by Judge Soper are two other issues that have frequently been litigated.⁴⁷ So

⁴⁶ 192 F. 2d 286 (4th Cir., 1951).

⁴⁶ *Ibid.*, 290-91. But see early case of *Chapman v. Emerson*, 8 F. 2d 353 (4th Cir., 1925) upholding a transaction even though assignor used some collections for his own purposes. This case has seldom been followed; to the judges of the Fourth Circuit, it came to represent nothing more than a nuisance, an anomaly to be distinguished. One writer has this to say of the Chapman case: "The opinion is short, not fully reasoned, and misses entirely the theory . . ." Lauchheimer, *Some Problems of Modern Collateral Banking*, 26 Col. L. Rev. 129, 134, fn. 25 (1926). The process of sterilizing the Chapman case began a few months later in *In re Almond-Jones Co.*, 13 F. 2d 152 (D. Md., 1926), *aff'd. sub nom.* *Union Trust Co. v. Peck*, 16 F. 2d 986 (4th Cir., 1927), *cert. den.* 273 U. S. 767 (1927). "The [Chapman case] was on the border line, as our opinion in it clearly pointed out. It went as far as we think we can properly go." 16 F. 2d 986, 987. See also *In re Goodhue Motor Co.*, 28 F. 2d 402 (D. Md., 1928) for another valid arrangement.

⁴⁷ See also footnote 2 in Judge Soper's opinion in the *Mount* case, 192 F. 2d 286, 290 (4th Cir., 1951).

that the assignor can make use of the collected funds for his every day needs, the assignee often permits him to substitute new accounts of equal value at the time of each collection. The new accounts are subject to the assignee's lien and a very practical and beneficial revolving fund is created. This arrangement avoids the necessity of new loans on the assignment of each new account, and generally keeps the working capital of the assignor adequate and constant. The mechanics of this arrangement must be closely scrutinized by the assignee. The courts will uphold its validity if the substitution of the new accounts occurs before or at the same time as the withdrawal of the old accounts. If this requirement is fulfilled, the assignor is not regarded as having fraudulent dominion over the property. But if the assignor first withdraws the proceeds of the old account, and then substitutes the new account, the arrangement is invalid.⁴⁸

A related problem arises with respect to goods returned to the assignor by the account debtor. Where such goods are covered by the assignment contract, the entire transaction will be deemed fraudulent if the assignor is permitted to assert full control over the returned goods. In a leading case, the Second Circuit invalidated the whole security arrangement where the returned goods represented only 1¾ % of the total security.⁴⁹ But if the assignor is required to substitute new accounts for those goods before exercising control over them, the transaction will be valid since the assignor does not have "unfettered" dominion over the goods.⁵⁰

Another interesting problem was presented to Judge Soper in two cases decided in May, 1926. Where the proceeds are deposited in a bank account from which the assignor has complete power of withdrawal, the arrangement will be invalid. Is there any difference when the

⁴⁸ *In re Pusey, Maynes, Breish Co.*, 122 F. 2d 606 (3rd Cir., 1941); *In re Lambert & Braceland Co.*, 29 F. 2d 758 (E. D. Pa., 1928); *In re Vanity Fair Slippers*, 4 F. Supp. 83 (S. D. N. Y., 1933). *Cf. Manufacturers' Finance Co. v. Armstrong*, 78 F. 2d 289 (4th Cir., 1935) where bankrupt validly paid assignee bank with its own check rather than send to the bank trade acceptance received from its customers.

⁴⁹ *Lee v. State Bank & Trust Co.*, 38 F. 2d 45 (2d Cir., 1930), 54 F. 2d 518 (2d Cir., 1931). This "part-bad-all-bad" theory originated in *Brown v. Leo*, 12 F. 2d 350 (2d Cir., 1926) which held that a mortgage of land and chattels where the mortgagor retained dominion and control over the chattels was void both as to the chattels and the land.

⁵⁰ *In re Bernard & Katz*, 38 F. 2d 40 (2d Cir., 1930). If new accounts are not substituted, but the goods themselves are to be held for the assignee, a written assignment must so provide since the lien on the accounts does not automatically apply to the returned goods. *In re Vanity Fair Slippers*, 4 F. Supp. 83 (S. D. N. Y., 1933).

bank of deposit is the assignee, which has reserved the right to remove the funds from the account at anytime and apply them to the debt? It was held in *In re Almond-Jones Co.*⁵¹ that since the bankrupt still had the power to withdraw the proceeds and use them as it saw fit, the assignment was fraudulent. The existence of the bank's unexercised prerogative to remove the funds could not save the arrangement.⁵²

Where, however, the assignor deposits the collections in the assignee bank and must secure permission from the assignee before he is allowed to use these funds, the arrangement is valid. In *In re Monumental Shoe Mfg. Co.*,⁵³ with each deposit, a check equal to the sum total of the deposit was drawn by the assignee in favor of the assignor and deposited to the credit of the assignor, from which deposit the assignor could withdraw freely. Validating this plan, Judge Soper said that if the right to use the money is given by the assignee bank coincidentally with the assignment, as in the *Almond-Jones* case, the bank loses its claim; but if the right to use the money is withheld at the time the assignment is made, and "was granted only, as to each account, after the proceeds had been collected and placed within the bank's control",⁵⁴ the bank will prevail.⁵⁵

It is not easy to predict the legal effect of many of these arrangements.⁵⁶ Perhaps the best words of advice were written by Judge Soper in 1951:

"[T]he rights of the parties are to be determined by what they actually do rather than by the provisions of a contract which they disregard in giving effect to the transaction.

* * * * *

⁵¹ 13 F. 2d 152 (D. Md., 1926), *aff'd. sub nom.* Union Trust Co. v. Peck, 16 F. 2d 986 (4th Cir., 1927), *cert. den.* 273 U. S. 767 (1927).

⁵² Where the bank of deposit is the assignee, the problem of bankers' liens may arise. See *In re Almond-Jones*, 13 F. 2d 152 (D. Md., 1926); *Bank of Commerce & Trusts v. Hatcher*, 50 F. 2d 719 (4th Cir., 1931); and *Citizens' Nat. Bank of Gastonia, N. C. v. Lineberger*, 45 F. 2d 522 (4th Cir., 1930).

⁵³ 14 F. 2d 549 (D. Md., 1926).

⁵⁴ *Ibid.*, 551.

⁵⁵ See also *Kane v. Sesac*, 54 F. Supp. 853 (S. D. N. Y., 1943), held fraudulent where assignor deposited proceeds in a joint bank account requiring signature of assignor and assignee for each withdrawal, and assignee took out specific sum each month and permitted assignor to withdraw the balance.

⁵⁶ In states which require recordation of assignments of accounts receivable, the rule of *Benedict v. Ratner*, 268 U. S. 353 (1925), is not strictly applied. See *Second Nat. Bank of Houston v. Phillips*, 189 F. 2d 115 (5th Cir., 1951).

"It will be found, however, that the determination as to whether a case falls on one or the other side of the line depends upon the extent to which the parties intended that the borrower should keep or relinquish control of the proceeds of the accounts and the extent to which the right of the assignee to control the collateral has been enforced or abandoned."⁵⁷

Many states, but not Maryland, have passed legislation abrogating or amending the rule of *Benedict v. Ratner*.⁵⁸ It may be argued that if a lender wants to be careless with his security, he will be the one to suffer when the borrower picks up and absconds. It has also been argued that the rule of *Benedict v. Ratner* probably has a deterrent effect on financing. On the other hand, by following the policing requirements of the rule, an assignee protects himself from the dishonest borrower. If the assignee requires the borrower promptly to remit all checks collected from the account debtors, the assignee will have immediate warning of a decline in the borrower's collections and a delayed warning of any decline in sales. Also, as one writer points out:

"[B]y investigating the checks, the [assignee] can discover whether the borrower has been supplying him with false invoices and hence actually assigning him nothing, repaying the [assignee] with his money. In such a case, the borrower may be 'kiting' his assignments, i.e., keeping one step ahead of the [assignee] by presenting to him the appearance of a growing business, making ever increasing assignments of false accounts and securing larger and larger loans."⁵⁹

⁵⁷ Mount v. Norfolk Savings & Loan Corp., 192 F. 2d 286, 290 (4th Cir., 1951).

⁵⁸ 268 U. S. 353 (1925). See note, 101 Univ. of Pa. L. Rev. 392, 397 (1952), Uniform Commercial Code (1957 off. ed.) §9-205.

⁵⁹ Note, *Ibid.*, 394. In Manufacturers' Finance Co. v. Armstrong, 78 F. 2d 289 (4th Cir., 1935), assignor was permitted to substitute his own checks, a dangerous practice. See also Webb v. Balto. Commercial Bank, 181 Md. 572, 31 A. 2d 174 (1943), for another instance where policing would have aided the assignee by preventing the assignor from fraudulently negotiating debtor's checks to a third party.

On the desirability of *Benedict v. Ratner*, *supra*, n. 56, compare 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (Rev. ed. 1940), §§582-94 with Cohen and Gerber, *Mortgages on Accounts Receivable*, 29 Geo. L. J. 555 (1941). See also Dunham, *Inventory and Accounts Receivable Financing*, 62 Harv. L. Rev. 588, 597-98 (1949); Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 Law and Contemp. Prob. 27, 36, 42-3 (1951). And see *In re New Haven Clock & Watch Company*, 253 F. 2d 577 (2d Cir., 1958) retreating from some of the Second Circuit's previous harsh rules.

3. Contract Provisions Forbidding Assignment

Another impediment to accounts receivable financing is the existence in many contracts and purchase orders of a clause prohibiting assignment by the seller of the contract or order. The courts have generally held that such clauses are valid and effectively prohibit assignments of any claims.⁶⁰ A leading case is *Allhusen v. Caristo Const. Corp.*,⁶¹ which involved an assignment to a bank of moneys due and to become due under a contract which contained the provision: "The assignment . . . of any money due or to become due . . . without the written consent of [the account debtor] shall be void." The Court of Appeals of New York unanimously held that the prohibitory clause was a complete defense to the action by the assignee.⁶²

There do not appear to be any Maryland cases dealing with the validity of these clauses in the accounts receivable fields. In other areas our Court of Appeals has consistently held that if such a clause is included in a contract, it must be enforced. In *Bimestefer v. Bimestefer*,⁶³ an insurance company issued a policy expressly providing that it could not be assigned by the insured, but giving him the power to change the beneficiary. The insured gave the policy to his son saying, "This is yours." Later the insured married a second wife and procured a new policy payable to her, replacing the one held by the son although the son was not required to deliver up his policy. When the insurer died, the son and widow both demanded payment from the company. It was held that the prohibition against assignment defeated the gift of the policy to the son. The son never obtained an indefeasible title to the policy; he was only a beneficiary who could be replaced by another beneficiary if the insured desired.

"[T]he concept of freedom to contract has been recognized by the courts. In large measure, they agree that the parties may limit the alienation of rights and prohibit assignment of rights under contract where clear language and plain words have been chosen."⁶⁴

In Maryland, the Court of Appeals has continually recognized this policy of freedom of contract by invalidat-

⁶⁰ See 4 CORBIN, CONTRACTS (1951) §§872-73; Comment, 25 Univ. of Chi. L. Rev. 199 (1957).

⁶¹ 303 N. Y. 446, 103 N. E. 2d 891 (1952).

⁶² See scathing criticism of this case by Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 Yale L. J. 1057, 1118-19 (1954).

⁶³ 205 Md. 541, 109 A. 2d 768 (1954).

⁶⁴ *Ibid.*, 546.

ing attempted assignments when there is a prohibitory provision in the contract.⁶⁵ Therefore it would be advisable for merchants who plan to assign their accounts receivable to examine their sales contracts and eradicate no-assignment clauses. Indeed, from a long range point of view, the account debtor should not be displeased if the assignor is able to expand his business by borrowing money. In addition, it should make little practical difference to the account debtor whether he pays the assignor or the assignee.⁶⁶ If the debtor is not notified of the assignment, he is fully discharged when he pays the assignor and should not care whether the assignor deposits the check in his own account or turns it over to an assignee.⁶⁷

INVENTORY FINANCING

The classic form of chattel security was the pledge. This transaction involved the delivery to the lender-pledgee of the chattel pledged. If the borrower-pledgor retained the chattel, the transaction was invalid. This fundamental rule of pledge law was based on the reasoning that if the borrower retained possession of the chattel, his creditors would

⁶⁵ See *Michaelson v. Sokolove*, 169 Md. 529, 182 A. 458 (1936) (insurance policy); *Dale v. Brumbly*, 96 Md. 674, 54 A. 655 (1903) (fraternal benefit society policy); *Yake v. Yake*, 170 Md. 75, 183 A. 555 (1936) (upholding prohibition of assignment of compensation payable under World War Veterans' Relief Act); *Andrew v. Meyerdirck*, 87 Md. 511, 40 A. 173 (1898) (upholding prohibition of assignment in lease). *Cf.* *In re Bresnan*, 45 F. 2d 193 (D. Md., 1930). The insurance cases might be distinguished because of a relevant difference between insurance policies and accounts receivable. The purpose of no-assignment clauses in insurance policies is to prevent the insured from selling the policy to pay his debts without providing for widow and children. In one case, *Michaelson v. Sokolove*, *ibid.*, 533, the Court likened this clause to the creation of a spendthrift trust. See also good discussion by Judge Hammond in *Bimestefer v. Bimestefer*, 205 Md. 541, 546-551, 109 A. 2d 768 (1954). *Quaere*: Does the same policy exist with assignments of accounts receivable; should not the policy of encouraging the expansion of business prevail?

⁶⁶ It must be remembered that we are not dealing with assignability of performance. There may be valid reasons for prohibiting an assignment of such a material part of a contractual obligation. The debtor may very definitely desire that performance be carried out only by the person with whom he contracted. But the destination of his check would make little difference to him. The Uniform Commercial Code (1957 off. ed.) recognizes this reasoning in §9-318(4): a clause prohibiting assignment of *proceeds* will not be enforced.

⁶⁷ Of increasing importance is the assignability of claims under government contracts and the special laws pertaining thereto. See Assignment of Claims Act, 65 STAT. 41 (1951), 31 U. S. C. A. §203 (1957), especially provisions allowing "no-set-off" clauses, which prevent the government from setting off tax or renegotiation claims which it may have against the assignor. *Central Bank v. United States*, 345 U. S. 639 (1953); *Nichols, Assignment of Claims Act of 1940 — A Decade Later*, 12 Univ. of Pitt. L. Rev. 538 (1951); Note, 101 Univ. of Pa. L. Rev. 106 (1952); *In re Cummins Const. Corporation*, 81 F. Supp. 193, 198-99 (D. Md., 1948).

easily be misled into extending credit on his false appearance of ownership.⁶⁸

The pledge, however, was not a very practical device for the solution of the problems of inventory financing. The merchant or manufacturer borrowing on the security of his stock-in-trade or raw materials did not want to relinquish the collateral, for unless he remained in possession, he would be unable to sell the stock-in-trade or process the raw materials into finished goods.

This obvious inadequacy of the pledge led to widespread attempts to mold the ancient real property mortgage into a device known as the chattel mortgage. The chattel mortgage, like its ancestor, was simply a conveyance of title to the chattel from the mortgagor-borrower to the mortgagee-lender, subject to defeasance on payment by the mortgagor of the mortgage debt. Possession of the chattel, however, did not follow the title, for the borrower remained in possession.

The early chattel mortgage met a macabre fate. The familiar Statute of Elizabeth⁶⁹ declared that the retention of possession by any mortgagor or vendor of goods was evidence of fraud. In other words, if Farmer Jones, borrowing money from Mr. Lender on the security of his six horses, executed a chattel mortgage and retained possession of the horses, the Statute rendered this transaction subject to attack from Jones' creditors. This statutory prohibition was based on the same theory that invalidated pledges without delivery; viz., retention of possession by the mortgagor or pledgor gave an impression of opulence which was likely to mislead creditors. If a creditor couldn't rely on the fact that Farmer Jones' possession of the horses meant ownership, there would be no way of calculating the credit risk, or, in the modern vernacular, Farmer Jones' "credit rating". Without the Statute of Elizabeth, creditors seeking to execute on Farmer Jones' property in the event that the latter became insolvent would find it impossible to seize the six horses on which they had relied in extending credit. The secret mortgagee, Mr. Lender, would suddenly come forward with his prior right to the horses and defeat the claim of the creditors who had relied on the insolvent's

⁶⁸ "It is a well established principle that possession is necessary to perfect a title by pledge, and it is equally well settled that the delivery back of the possession of the thing pledged, by the act or with the consent of the pledgee, terminates his title, . . ."

Citizens Nat'l Bank v. Hooper, 47 Md. 88, 102 (1877). See also *In re Spanish-American Cork Products Co.*, 2 F. 2d 203, 204 (4th Cir., 1924), *cert. den.* 266 U. S. 634 (1925).

⁶⁹ 13 ELIZ., c. 5 (1570), 1 ALEX. BRIT. STATS. (1912) 499.

"ostensible ownership". The chattel mortgage with the mortgagor in possession, therefore, was nothing more than an invalid pledge dressed up in fancy garb.⁷⁰

Consequently it was impossible for a lender to have a valid security interest without taking possession of the borrower's property. Whether the legal instrument was called a mortgage, a pledge, or by any other name, it was still invalid. In 1729, the Maryland Legislature loosened some of the shackles on secured lending by passing an act which permitted the mortgagor of goods to remain in possession provided that the mortgage was recorded.⁷¹ The theory behind the recording act was simple enough: recording was tantamount to possession. In pledge law, the principal function of requiring possession to be out of the borrower was presumably the notoriety which it provided to his creditors. Under the recording laws, on the other hand, possession could remain in the borrower so long as the lender recorded his security interest.

A creditor of the borrower could no longer blithely rely on ostensible ownership; diligence required him to search the record books to determine whether the debtor had true ownership, which was, in the eyes of the law, something more than ostensible ownership. If a search were made and no encumbrances on the debtor's ownership were discovered, the creditor would not be obliged to fear the recondite lender. If, however, encumbrances were recorded and the creditor nevertheless extended credit, he could not thereafter complain to the encumbrancer that he was misled by the debtor's possession, for recordation of the instrument evidencing the transaction gave constructive notice to all those interested, including creditors, that the lien or conveyance existed.⁷²

The recording acts solved the initial problem of permitting the borrower to remain in possession of the security while at the same time preserving the validity of the lender's claim. The next hurdle, however, was impassable. Although the chattel mortgage worked well enough when the collateral was an identifiable chattel such as a piece of equipment, when the lender tried to encumber something

⁷⁰ Another sham, also invalidated by the Statute of Elizabeth, was the bill of sale with the vendor remaining in possession of the goods. See 2 WILLISTON, SALES (Rev. ed. 1948), §§353, 373.

⁷¹ MD. LAWS 1729, Ch. 8, §5, 2 MD. CODE (1957), Art. 21, §41.

⁷² For construction of the chattel mortgage recording act, see *Balto. Credit Union v. Thorne*, 214 Md. 200, 134 A. 2d 84 (1957); *Millikin v. Second Nat. Bank*, 206 Fed. 14 (4th Cir., 1913); *Textor v. Orr*, 86 Md. 392, 38 A. 939 (1897); *Cahoon v. Miers*, 67 Md. 573, 579-80, 11 A. 278 (1887); *Gill v. Griffith*, 2 Md. Ch. 270 (1848); *Hudson v. Warner & Vance*, 2 H. & G. 415 (Md., 1828).

like a shifting stock of goods or inventory, he very often found that the chattel mortgage broke down.

Essentially there were two reasons for this breakdown: (i) the invalidity of a chattel mortgage on after-acquired property,⁷³ and (ii) the fraudulence of a chattel mortgage which reserved to the mortgagor the right to sell the collateral and to apply the proceeds thereof to the purchase of new goods.⁷⁴ Seizing these related concepts, the Court

⁷³ See *Grimes v. Clark*, 234 Fed. 604 (4th Cir., 1916), *aff'g*. *Clark v. Grimes*, 232 Fed. 190 (D. Md., 1916); *First National Bank v. Lindenstruth*, 79 Md. 136, 28 A. 807 (1894); *Crocker v. Hopps*, 78 Md. 260, 28 A. 99 (1893); *Rose v. Bevan*, 10 Md. 466 (1857); *Hamilton v. Rogers*, 8 Md. 301 (1855). There are apparently several vague exceptions: (1) where the mortgagor is a "public service corporation", *Brady v. Johnson*, 75 Md. 445, 26 A. 49 (1892) (canal company); *Butler v. Rahm*, 46 Md. 541 (1877) (railroad company); *Boyd v. C. & O. Canal Co.*, 17 Md. 195 (1861) (canal company), and see *dicta* in *Mallory v. Maryland Glass Co.*, 131 Fed. 111, 113 (D. Md., 1904) and *Diggs v. Fidelity & Deposit Co.*, 112 Md. 50, 72, 75 A. 517 (1910); (2) where the mortgage covers only a small part of the mortgagor's property: compare attitude of court in *Wilson v. Wilson*, 37 Md. 1 (1872) and *Aged Men's Home v. Pierce*, 100 Md. 520, 60 A. 277 (1905), where individuals were not allowed to sell or assign all the property they will acquire in the future to the attitude in *Leupold v. Weeks*, 96 Md. 280, 53 A. 937 (1903) and *Keys v. Keys*, 148 Md. 397, 129 A. 504 (1925), where after-acquired property in question constituted only a fraction of the total estate of the vendor or assignor; (3) where the mortgage covers future animals and crops, *In re Cook*, 9 F. Supp. 764 (D. Md., 1935) (crops), *G. Ober & Sons Co. v. Keating*, 77 Md. 100, 26 A. 501 (1893) (crops), *Cahoon v. Miers*, 67 Md. 573, 11 A. 278 (1887) (animals), and *Evans v. Merriken*, 8 G. & J. 39 (Md., 1836) (slaves — the fate of the mother determines that of the child); and (4) where the case arose in equity, see cases cited in *Weiprecht v. Ripple*, ... Md. ..., 143 A. 2d 62 (1958). See also Cohen and Gerber, *The After-Acquired Property Clause*, 87 Univ. of Pa. L. Rev. 635 (1939), 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (Rev. ed. 1940) §§565-581, and 4 COLLIER, BANKRUPTCY (14th ed., Moore and Oglebay, 1942) §70.82. The Uniform Sales Act, which contemplates the sale of "future goods" in 7 MD. CODE (1957), Art. 83, §23(3), does not sanction mortgages of future goods; see §93. 2 MD. CODE (1957), Art. 21, §§52-56, originally passed in 1935 to benefit farmers, (MD. LAWS 1935, Ch. 281), §52 having been amended in 1945 to broaden its coverage, (MD. LAWS 1945, Ch. 381), apparently permits, in some instances, chattel mortgages on after-acquired property. This statute is vague and has not yet been construed, except in *In re Calhoun Motors*, 55 F. Supp. 397 (D. Md., 1944), where its constitutionality was upheld. It creates another record book — the "Credit Lien Book" (§58) and relaxes some of the formal requirements in executing ordinary chattel mortgages so as to obviate the effect of cases like *Tyler Co. v. O'Ferrall*, 153 Md. 353, 138 A. 249 (1927) and *In re Leven*, 42 F. Supp. 484 (D. Md., 1941), where defects in execution invalidated mortgage. The curative acts, 2 MD. CODE (1957), Art. 21, §§96-99, will probably be of no avail in bankruptcy because of §70(e) of the Bankruptcy Act, 11 U. S. C. A. §110(e) (1953). *In re Leven*, *ibid*, and §70(c), *ibid*, §110(c), *Constance v. Harvey*, 215 F. 2d 571 (2d Cir., 1954), *cert. den.* 348 U. S. 913 (1955). But see *Sandler v. Freeny*, 120 F. 2d 881 (4th Cir., 1941).

⁷⁴ *Grimes v. Clark*, *supra*, n. 73 and *Butler v. Rahm*, *supra*, n. 73 at 548. Where, however, the mortgagor was required to account to the mortgagee for the proceeds of sale, the mortgage was valid. *Edelhoff v. Horner-Miller Mfg. Co.*, 86 Md. 595, 39 A. 314 (1898); *In re Durham*, 114 Fed. 750 (D. Md., 1902). See also Cohen and Gerber, *Mortgages of Merchandise*, 39 Col. L. Rev. 1338 (1939); 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (Rev. ed. 1940), §§582-94; 4 COLLIER, BANKRUPTCY (14th ed., Moore and Oglebay, 1942) §70.77.

of Appeals regularly struck down attempts to use the chattel mortgage in the inventory financing area.

Why does the efficacy of inventory financing depend on the inclusion of both a clause attaching the lender's interest to after-acquired property and a clause permitting the borrower to sell the collateral and apply the proceeds to his own use? The after-acquired property clause allows the interest of the lender to extend to goods which the borrower may acquire after the execution of the security agreement. Without this clause the only way in which the lender could retain the full value of his security interest would be by preventing the borrower from selling any of his goods. Similarly, for the arrangement to function effectively, the borrower must be given the power to sell his stock-in-trade and with the proceeds to purchase more inventory. For if the borrower must immediately pay all the proceeds to the lender, he will soon need further financing since he will have to purchase new inventory. Although it may be true that where the borrower's business requires merely occasional loans so that there will be only a slight inconvenience in turning over the proceeds and receiving new loans, in many businesses the turnover is rapid and the need for a constant flow of inventory to replace sold merchandise is paramount.

1. *Trust Receipt*

The restrictions that prevented effective utilization of the chattel mortgage led to a search for a better tool with which a merchant could finance his business. Legal ingenuity finally discovered in the importing field a rather curious device known as the trust receipt.⁷⁵ Basically, the

⁷⁵ For early history of trust receipts, see Frederick, *The Trust Receipt as Security*, 22 Col. L. Rev. 395 and 546 (1922). To facilitate the financing of imports, an importer would request his bank to open a letter of credit naming his foreign supplier as beneficiary. The supplier, more willing to rely on the credit of a bank than an unfamiliar purchaser in a foreign country, then made out order bills of lading in the name of the importer's bank, thus giving the bank the necessary security interest in the transaction. When the bills of lading were presented to the bank, the supplier received immediate payment. See FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* (1930); Trimble, *The Law Merchant and the Letter of Credit*, 61 Harv. L. Rev. 981 (1948). The bank, having title to the goods, turned the bills of lading over to the importer who executed a "trust receipt" in favor of the bank. When the importer sold the goods, he would be able to repay the loan to his bank; but in the meantime, the bank had a valid security interest in the goods and apparently on the proceeds of sales. A typical example of this use of trust receipts appears in the Maryland case of *Barry v. Boninger*, 46 Md. 59 (1877), which, incidentally, is the earliest reported case in any jurisdiction in which the term "trust receipt" is used. The Court of Appeals upheld the banker's security interest in the imported goods and their proceeds of sale under the trust receipt which the importer had executed.

trust receipt transaction involves three persons: a manufacturer or distributor, a retailer dealer — the trustee, and a finance company or bank — the entruster — that is financing the dealer's inventory purchases. The trustee orders goods from the manufacturer, having previously arranged with the entruster to advance the necessary funds. The merchandise so ordered is shipped under a bill of lading made out to the order of the manufacturer and by him endorsed in blank, to which a draft for the purchase price has been attached. When these documents arrive, the entruster honors the draft and acquires possession of the bill of lading. The bill of lading is then turned over to the trustee but only after the latter has executed two instruments: (i) a note in favor of the entruster for the money advanced toward the purchase price of the property, and (ii) a trust receipt by which he acknowledges that the property being turned over to him belongs to the entruster and under which he agrees to hold it in trust and according to the tenor of the instrument. As a general rule, the trust receipt provides that the property taken thereunder can be sold, warehoused, or manufactured and then sold, the proceeds of sale being applied to the debt. Once having possession of the bill of lading, the trustee can obtain the goods from the carrier and utilize them in the manner set forth in the trust receipt. The main purpose of the transaction is to lodge title in the entruster as security for the funds advanced, while permitting the trustee to obtain possession of the goods with the privilege of sale. In its early days, this transaction was the *pièce de résistance* to the policy of the recording acts, for in the trust receipt transaction, the borrower was the ostensible owner while title was vested in another party.

Soon after 1900, the value of the trust receipt was quickly recognized by the budding automobile industry. One of the chief problems of this industry stemmed from the precarious position of the dealer. On the one hand, he was faced with the unique demand of the manufacturer for cash payment before delivery.⁷⁸ On the other hand,

⁷⁸ "So far as the manufacturer is concerned there are no such things as accounts receivable or notes receivable from automobile dealers; technically the manufacturer receives cash in full before he delivers either title to the merchandise or even makes physical delivery of it to a transportation agency for transmission to the dealer."

FTC, Report on Distribution Methods and Costs, Part IV, 94 (1944), quoted in Skilton, *Cars for Sale: Some Comments on the Wholesale Financing of Automobiles*, 1957 Wis. L. Rev. 352, 357, n. 8. The Skilton Article is an excellent exposition of the legal and business problems of automobile financing.

when the dealer sold his cars to consumers, the transaction was very often conducted on an installment purchase plan (such as a conditional sales contract) wherein he received little cash at the moment of delivery. Since the ready cash which he needed to purchase new cars was not forthcoming from the consumer, the dealer turned to finance companies and the trust receipt. The finance companies⁷⁷ would pay for the dealer's inventory and were the given trust receipts on each car delivered to the dealer. The security interest was free from recordation and the lien of the finance company extended to the proceeds of dealer sales.⁷⁸

As the reader may suspect, a reaction quickly arose and the utility of the device was somewhat curtailed. Some courts thought that "in reality" the trust receipt was just another form of chattel mortgage or conditional sale, and consequently it could create a valid security interest only by conforming to the recording acts and other statutes dealing with those devices. Other courts invalidated "bipartite" arrangements where the dealer acquired goods or documents of title *directly* from the manufacturer. The model transaction, and the only valid one, was the "tripartite" arrangement where the dealer obtained the goods or documents of title from the financier, who had previously obtained them from the seller or manufacturer.⁷⁹

⁷⁷ G.M.A.C. (General Motors Acceptance Corporation) was formed in 1919 to assist G.M. dealers in wholesale and retail financing. See *United States v. General Motors Corp.*, 121 F. 2d 376 (7th Cir., 1941), for a history of G.M.A.C. A few years later, Ford and Chrysler became respectively related to Universal Credit and Commercial Credit.

⁷⁸ The proceeds of sales by dealers to consumers usually took the form of conditional sales contracts. Indeed, the finance companies made less money on trust receipt financing than on the discounting of these conditional sales contracts.

⁷⁹ The one Maryland case arising during the period when the auto finance companies were beginning to use the trust receipt was *In re Cullen*, a beautifully written opinion in 282 Fed. 902 (D. Md., 1922). District Judge Rose captured the confusion of the era and the travail of the trust receipt in his opening paragraph:

"The question in this case is how far a serviceable nag may be ridden, or less metaphorically, may the so-called 'trust receipt', highly useful in certain kinds of commercial transactions, and which the courts have in consequence struggled to sustain, in spite of its apparent conflict with the recording laws, be upheld when the principal, if not the sole, reason for resorting to it, is to escape from those very statutes."

Ibid. Judge Rose avoided many of the problems in this area by holding that the transaction in the case was a bipartite transaction and not a true trust receipt transaction. Here the manufacturer, the Hupp Motor Car Corporation sold cars to a dealer, retained a lien upon them for the balance of the purchase price, and assigned the lien to a finance company as security for advances made by the latter. In other words, title to the cars passed directly from the manufacturer to the dealer. Orthodoxy would not recognize such a deviate. Since the instrument was not a "true" trust receipt, the failure to record it vitiated the finance company's claim. Four

Out of a great welter of confusion, some measure of certainty finally appeared in the form of the Uniform Trust Receipts Act (UTRA),⁸⁰ adopted in Maryland in 1941.⁸¹ This statute was designed to promote the commercial utilization of the trust receipt transaction by freeing it from the formalism of the "bipartite-tripartite" controversy and by providing an answer to the recording squabble. It is not the purpose of this article to analyze the details of the UTRA.⁸² Only a brief summary will be given, the Maryland cases will be cited, and finally a few of the troublesome problems under the statute will be mentioned.

The Act provides that if a dealer desires to finance the purchase of stock-in-trade, he may enter into an arrangement with a bank or finance company and file a statement of the agreement between the parties with the State Tax Commission. The form and contents of the statement are extremely general in nature. The statement simply recites the names and chief places of business of the financier (called an "entruster") and the merchant-borrower (called a "trustee"), the fact that the entruster is engaged, or expects to be engaged, in financing under trust receipt transactions the acquisition of goods by the trustee, and a general description of the kind of goods covered by such financing, such as "coffee, silk, automobiles, or the like".

When the entruster delivers the bill of lading to the dealer, the latter as trustee executes and delivers to the entruster a trust receipt which must "designate" the goods covered by the receipt. The trust receipts themselves are not required to be recorded or in any way actually or constructively brought to the notice of general creditors of the merchant. The creditors receive notice of the financing arrangement from the general statement on file with the State Tax Commission.

months later, the Fourth Circuit said that the South Carolina recording law, which the Court compared to a "like Maryland statute", invalidated unrecorded trust receipts because they were in the nature of conditional sales. *Industrial Finance Corporation v. Cappleman*, 284 Fed. 8, 12 (4th Cir., 1922).

⁸⁰ Reprinted in 9C Uniform Laws Annotated (1957) 220 *et seq.* hereinafter cited as U. L. A. The Uniform Trust Receipts Act will hereinafter be cited as UTRA. The UTRA was approved by the National Conference of Commissioners on Uniform State Laws in 1933 and has been adopted by thirty-two states.

⁸¹ The UTRA appears today as 8 Md. CODE (1957), Art. 95½, and the section numbers are the same.

⁸² For further information on the UTRA, see MCGOWAN, *TRUST RECEIPTS* (1947); Heindl, *Trust Receipt Financing under the Uniform Trust Receipts Act*, 26 Chi-Kent L. Rev. 197 (1948); Rudolph, *Judicial Construction of the Trust Receipts Act and its reflection in the Commercial Code*, 19 Univ. of Pitt. L. Rev. 1 (1957); Commissioners' Prefatory Note, 9C U. L. A. (1957) 220-230.

When the trust receipt has been executed or delivered to the entruster, and when the statement of trust receipt financing has been filed in the State Tax Commission, the entruster will have a valid security interest in the goods covered by the trust receipts. The Act also provides that the filing of the general statement protects the entruster as to all trust receipts executed within one year after the filing and also relates back to protect all trust receipts executed within thirty days before the filing.⁸³ Finally, it should be pointed out that there is a central filing place for the "general statement" in the State Tax Commission office. This differs from the recordation provided for by the chattel mortgage, conditional sales, and factors' liens recording acts where recording is on a local county basis.

The only two cases in Maryland which have involved an interpretation of the UTRA dealt primarily with the execution of the trust receipt itself. *In re Yost*⁸⁴ denied the right of the entruster to substitute goods which the dealer-trustee had received from the manufacturer in exchange for returned defective goods on which trust receipts had previously been executed.⁸⁵ This case, of course, demonstrates that the financier must scrupulously insist that the dealer execute and deliver to him trust receipts on every article which the financing arrangement is supposed to cover. The general statement that is filed with the State Tax Commission will not help the financier in the event of the dealer's bankruptcy if the financier does not have trust receipts on the individual articles which he may be trying to reclaim.

*In re Nickulas*⁸⁶ was a reclamation proceeding where the trustee in bankruptcy contended that the trust receipts were invalid because they described only the model and serial number of the refrigerators in question and not the

⁸³ Notwithstanding the thirty-day provision, it is inadvisable to allow more than 21 days to elapse before filing, because under §60 of the Bankruptcy Act, 11 U.S.C.A. §96a(7) (1957) a security interest must be perfected within 21 days though a state statute may allow a longer period. See Arnold, *The 1950 Amendment to the Preference Section of the Bankruptcy Act and Maryland Law*, 14 Md. L. Rev. 311, 330-33 (1954).

⁸⁴ 107 F. Supp. 432 (D. Md., 1952). The UTRA was also mentioned in *Hoffman v. Seth*, 207 Md. 234, 114 A. 2d 58 (1955).

⁸⁵ §10 of the Act provides that the entruster's lien attaches to the proceeds of sale or other disposition of the goods covered by the trust receipt. Query, weren't the substituted goods in *In re Yost*, *ibid.*, "proceeds" within the meaning of §10; see *infra*, text at n. 97. The point apparently was not raised.

⁸⁶ 117 F. Supp. 590 (D. Md., 1954), *aff'd. sub nom* *Tatelbaum v. Refrigeration Discount Corp.*, 212 F. 2d 877 (4th Cir., 1954). The latter was a *per curiam* order, adopting Judge Chesnut's opinion in the District Court as the opinion of the Fourth Circuit.

name of the maker nor the nature of the chattel. Judge Chesnut pointed out that anyone familiar with the customs of the trade could readily identify the manufacturer and type of article from the model and serial numbers. Moreover, since creditors are not directly interested in the description of the articles, at least before bankruptcy, the description in the trust receipts need only be sufficient enough to enable the borrower and the entruster to identify the particular articles.⁸⁷

It was also ruled in *In re Nickulas* that an entruster under the Maryland Trust Receipts Act was not obligated to see that the trustee also complied with the Agents and Factors Act⁸⁸ of Maryland. This is a law which provides that a person doing a mercantile business as an agent for another or in a name other than his own must file in the clerk's office of the appropriate city or county a designation of the name and address of the true owner of the business, and if he fails to do so any creditor can sue the debtor in the name of the agent of the true owner of the business and subject any property on the premises to satisfy his claim. In the instant case, Nickulas, an individual, was the bankrupt, but he was trading under the name of Manor Sales. It was contended that non-compliance by Nickulas with the recording requirements of the Agents and Factors Act vitiated the claim of the entruster. Judge Chesnut refuted this argument by pointing out that:

"The Uniform Trust Receipts Act is a complete and independent Act of itself and when complied with protects the 'entruster' of the goods against attack by the trustee in bankruptcy."⁸⁹

Therefore the entruster is under no obligation to see that the bankrupt has complied with the Agents and Factors Act.⁹⁰

⁸⁷ This argument might be subject to attack on the ground that a diligent creditor looking at the actual trust receipt could ascertain nothing if the descriptions were vague. The decision in the instant case, however, is sound.

⁸⁸ 1 Md. CODE (1957), Art. 2, §§18 and 20. See *infra*, text at ns. 140-142.

⁸⁹ *In re Nickulas*, *supra*, n. 86, 593. See also 8 Md. CODE (1957), Art. 95½, §16:

"As to any transaction falling within the provisions both of this article and of any other act requiring filing or recording, the entruster shall not be required to comply with both, but by complying with the provisions of either at his election may have the protection given by the act complied with; . . ."

⁹⁰ It was also argued that the notice of trust receipt financing filed with the State Tax Commission was invalid because it had been indexed under the name of the business rather than in the name of the individual, Nickulas. To this technicality, Judge Chesnut replied that it was very common for individuals to conduct a business under a trade name. *Supra*, n. 86, 594.

Paucity of litigation under the UTRA has left many unanswered problems.⁹¹ Space permits mention of only one of them. The Act provides that "a buyer in the ordinary course of trade" takes free of the entruster's security interest.⁹² This provision was a necessity since there had been cases holding that an inventory lien survived in the hands of a bona fide retail purchaser.⁹³ Even the major finance companies recognized "that the retail purchaser was entitled to an automobile and not to a lawsuit".⁹⁴ The lien of the entruster, therefore, although good against creditors of the trustee, is not good against a bona fide purchaser.⁹⁵

But what is a buyer in the ordinary course of trade? Can another dealer be a buyer in the ordinary course of trade? Proliferation of models and colors in automobiles might cause a dealer to trade, for instance, a red car in his stock for a yellow car in another dealer's stock. Are

⁹¹ See e.g., Rohr, *Some Problems in Trust Receipt Financing*, 3 Wayne L. Rev. 22 (1956); Melvin, *Bankruptcy and the Automobile Dealer*, 34 N. C. L. Rev. 312 (1956); Carter, *The Trust Receipt and the Problem of Recordation or Notice Filing*, 1951 Wash. U. L. Q. 30; Comment, *Rights of Used Car Purchasers Under Trust Receipt Financing*, 52 Mich. L. Rev. 276 (1953); Note, 66 Yale L. J. 567 (1957) (discussing choice of proper place to file in multistate transactions); Note, 10 Okla. L. Rev. 53 (1957) (discussing trust receipt financing in a state without the UTRA).

⁹² 8 MD. CODE (1957), Art. 95½, §9(2)(a).

⁹³ See, e.g., *Finance, Etc. Co. v. Truck Co.*, 145 Md. 94, 125 A. 585 (1924), where the conditional vendor of a motor truck successfully replevied the truck from one who had purchased the truck from the conditional vendee. Despite the fact that the conditional vendor knew that the conditional vendee, a dealer, intended to sell the truck, the court felt that the vendor did not know that the vendee intended to sell the truck before paying for it.

⁹⁴ Kripke, *Inventory Financing of Hard Goods*, 1956 Univ. of Ill. L. Forum 580, 592.

⁹⁵ Before the 1950 Amendment to §60(a)(2) [11 U. S. C. A. §96 (1957)] of the Bankruptcy Act changed the standard by which perfection of liens was tested, there was some concern as to the validity of any trust receipt. Before the amendment, transfers were deemed to have occurred when they became so far perfected that no bona fide purchaser from the dealer could create rights in the property superior to the rights of the transferee. Since the entruster may never obtain rights superior to that of a buyer in the ordinary course of trade, the entruster's lien could never attain perfection. His lien was therefore deemed to have been transferred to the entruster on the eve of bankruptcy, which made the transfer "for or on account of an antecedent debt". The transfer was then vulnerable as a voidable preference. See §60(a)(1), (b), of the Bankruptcy Act [11 U. S. C. A. §96 (1943)]; *In re Harvey Distributing Co.*, 88 F. Supp. 466 (E. D. Va., 1950), *rev'd. sub nom.*, *Coin Acceptance Machine Corp. v. O'Donnell*, 192 F. 2d 773 (4th Cir., 1951). This undesirable state of affairs resulted in the amendment to §60(a), substituting a judicial lien creditor test for that of a bona fide purchaser; the entruster usually obtains rights superior to those of a judicial lien creditor. Therefore, his lien may be so perfected by filing in the State Tax Commission that the transfer of the security interest is deemed to have occurred at the time the trust receipt transaction created the debt. *Coin Machine Acceptance Corp. v. O'Donnell*, *ibid.*, 776. See also Arnold, *loc cit*, *supra*, n. 83.

purchasers at bargain prices, such as employees, relatives, or friends, buyers in the ordinary course of trade?

Assume that we have found this animal called "the buyer in the ordinary course of trade", and that he purchases an auto covered by a trust receipt. What happens to the entruster's lien? Section 10 of the UTRA states that the lien is transferred to the proceeds of sale if such a provision is included in the trust receipt. In addition, the UTRA provides that the lien on proceeds is waived by the entruster's failure to demand an accounting within ten days of the sale.⁹⁶

The problems become legion when it is realized that there are three different types of proceeds: trade-ins, receivables, and cash. On trade-ins, should the dealer execute a new trust receipt on the used car, or does the filing in the State Tax Commission of a statement of trust receipt financing give sufficient notice to creditors that trade-ins may be received as proceeds?⁹⁷ If the proceeds are conditional sales contracts, what happens if the latter are negotiated to another party? Would the purchaser of the installment paper be a "buyer in the ordinary course of trade?" Would he take entirely free of the entruster's lien on the contract?⁹⁸ When the proceeds are cash, to what extent does the entruster have to trace the cash if he is to preserve his lien? Is the entruster's lien a state-created priority which will be of no efficacy in bankruptcy or a state-created lien which will be recognized in bankruptcy?⁹⁹ To what extent does the doctrine of *Benedict v. Ratner*¹⁰⁰ affect the

⁹⁶ UTRA §10(c).

⁹⁷ From *In re Yost*, 107 F. Supp. 432 (D. Md., 1952), it might be argued that a new trust receipt should be executed, yet §10(b) might be an exception to the Yost rule. See *In re Car Leasing of America*, 109 F. Supp. 642 (S. D. Cal., 1953).

⁹⁸ See Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 Yale L. J. 1057, 1102-07 (1954). This situation will seldom arise, for the entruster usually purchases the conditional sales contracts. Indeed, financiers make a greater profit by financing these conditional sales contracts than by trust receipt financing. See Note, 66 Yale L. J. 922, 926 (1957), suggesting that to allow the entruster to maintain his security interest in this paper after its assignment to another would tend to decrease competition among consumer credit financiers and consequently exert an unfavorable influence on interest rates charged to consumers. See also, Note, 43 Cal. L. Rev. 733 (1955) (discussing fictitious sales and rights of assignees of conditional sales contracts).

⁹⁹ See *In re Harpeth Motors*, 135 F. Supp. 863 (M. D. Tenn., 1955), holding that an entruster's claim is not a priority but a lien. Compare with *In re Tele-Tone Radio Corp., Etc.*, 133 F. Supp. 739 (D. N. J., 1955) on the point of whether an entruster's lien is statutory so as to fall within §67(b) of the Bankruptcy Act [11 U. S. C. A. §107(b) (1953)], or is consensual, subject to §60 [11 U. S. C. A. §96]. See also Note, 66 Yale L. J. 922 (1957).

¹⁰⁰ 268 U. S. 353 (1925).

trust receipt transaction? The UTRA has a policing rule of its own which provides that the validity of the entruster's lien on the value of proceeds is conditioned on his demand for prompt accounting within ten days of sale. What happens if the trustee fails to comply with this demand? Must the entruster bring suit? It has been suggested that an "entruster who permits a dealer to continue business without promptly enforcing his lien, depends, just as any other unsecured creditor, on the dealer's honesty and continued solvency rather than on his collateral. Thus he should be placed in no better position than unsecured creditors . . ." ¹⁰¹ Actually policing should be viewed more as a rule of sound business than a legal technicality. If the entruster does not require prompt payment, the dealer may use the proceeds for other expenses, or even abscond.

What are the main limitations on the use of the trust receipt?

- (1) Stock already in the possession of the borrower may not be financed by means of a trust receipt.¹⁰² This will mean, for example, that when an appliance dealer already in possession of washing machines wishes to borrow money using these machines as collateral, the trust receipt will be unavailable.¹⁰³ Also, the trust receipt cannot be used as security for an antecedent indebtedness.
- (2) Where the financier has at any time more than a security interest in the goods, a trust receipt may not be used. Thus an owner of goods who sells on credit, retaining a security interest, cannot be an entruster.¹⁰⁴
- (3) The entruster's security interest covers only the particular chattel for which a trust receipt has been executed.¹⁰⁵ The interest does not constitute a general lien on any other goods of the trustee.¹⁰⁶ For each new addition to the borrower's inventory a new trust receipt must be given to the entruster.¹⁰⁷

¹⁰¹ 66 Yale L. J. 922, 933 (1957).

¹⁰² UTRA §2(1) (a), 8 Md. Code (1957), Art. 95½, §2(1) (a).

¹⁰³ *In re Chappell*, 77 F. Supp. 753 (D. Ore., 1948); *B-W Acceptance Corp. v. Crump Co.*, 199 Va. 312, 99 S. E. 2d 606 (1957). Several states, but not Maryland, have amended the Act to extinguish this restriction. See Kripke, *Inventory Financing of Hard Goods*, 1956 Univ. of Ill. L. Forum 580, 587.

¹⁰⁴ *Supra*, n. 102, §1.

¹⁰⁵ *Ibid.*, §14.

¹⁰⁶ See Kripke, *supra*, n. 103, 594-97, and fn. 70.

¹⁰⁷ *In re Yost*, 107 F. Supp. 432 (D. Md., 1952).

Hence, the UTRA has not provided a means for effectively acquiring a lien on after-acquired property.

- (4) Perhaps the greatest limitation of trust receipt financing is that it can successfully be used only in those types of businesses where the inventory consists of large items which can be handled on an individual basis. Where automobiles, washing machines, television sets, refrigerators, or machinery are the collateral, the UTRA provides a satisfactory framework. If, however, the items in the inventory cannot be individually identified, the trust receipt will be of doubtful utility. It must be remembered that the entruster should be able to identify the particular items on which he has a lien.¹⁰⁸

2. Warehousing

The earliest form of chattel security was the pledge.¹⁰⁹ Essential to the validity of the pledge was delivery of the collateral to the pledgee-lender. This requirement rendered the pledge impractical for inventory financing because of (1) the reluctance and inability of a lender such as a bank to take possession of goods, and (2) the impossibility of the borrower's conducting his business without remaining in possession of the inventory. Public warehousing solved the first problem, and its ingenious modern variant, field warehousing, solved the second.

Public warehousing is the storage of goods in a warehouse operated by an independent party called a warehouseman. The warehouseman, who has the status of a bailee for hire,¹¹⁰ issues warehouse receipts as evidence of the storage. Whoever presents these warehouse receipts to the warehouseman will be entitled to the goods.

Since the warehouse receipts represent the goods themselves,¹¹¹ a borrower can pledge the receipts, instead of his goods, with a bank or other lender. No longer will a pledge be unfeasible because the lender does not have the facilities for storing the borrower's pledged goods. Under the warehousing arrangement, the bank takes the receipts and

¹⁰⁸ *Ibid.*

¹⁰⁹ See *supra*, text at n. 68.

¹¹⁰ On duty of care owed by warehouseman, see Uniform Warehouse Receipts Act, 1 MD. CODE (1957), Art. 14A, §21. See also *Leckie v. Clemens*, 135 Md. 264, 108 A. 684 (1919), *Security Storage Co. v. Denys*, 119 Md. 330, 86 A. 613 (1913), and *B. & O. R.R. Co. v. Schumacher*, 29 Md. 168 (1868).

¹¹¹ See *Merchants' Nat. Bank v. Roxbury Distilling Co.*, 196 Fed. 76 (D. Md., 1912).

returns them to the borrower only when the loan is repaid. Then the borrower takes the receipts back to the warehouse where the original goods are restored to him.

The mechanics of warehousing are governed by the Uniform Warehouse Receipts Act which was enacted in Maryland in 1910.¹¹² This Act defines a "warehouseman", enumerates his obligations and rights, and prescribes the rules for the negotiation and transfer of warehouse receipts.

A big difficulty with public warehousing was that it provided no aid to the borrower who wished to retain the pledged goods in his plant. At this juncture, field warehousing entered the picture.¹¹³ Under field warehousing, instead of the goods going to the warehouse, the warehouse comes to the goods. The borrower sets aside part of his plant and leases it to a warehouse company. The latter segregates this area from the rest of the plant by erecting partitions and locking all entrances, posts numerous signs indicating its possession to the public, places similar placards on the warehoused materials thus separated from the rest of the borrower's property, puts a custodian in charge of the goods, and issues warehouse receipts which the borrower then pledges with the financier as security for a loan. This arrangement fully protects the financier, since the pledge of the warehouse receipts is just as effective as would be a pledge of the goods themselves.

There are two major reasons why field warehousing is more advantageous than regular public warehousing. First, there is no longer the expense and bother of shipping the goods from plant to warehouse and back again. Second, the borrower can easily withdraw a portion of the warehoused goods by bringing more goods into the "field warehouse". In other words, the borrower can withdraw warehoused raw materials, process them, re-warehouse them, and withdraw them again so long as he substitutes new collateral with each withdrawal. In this way the borrower can offer a shifting stock of goods as collateral.¹¹⁴

The courts will not tolerate any phony arrangements whereby the borrower actually retains control of the goods that are supposedly in the hands of the warehouse company. The section of the borrower's premises that is leased

¹¹² 1 MD. CODE (1957), Art. 14A. The Uniform Warehouse Receipts Act has been adopted in every state. See 3 U. L. A. (1922).

¹¹³ On field warehousing, see Friedman, *Field Warehousing*, 42 Col. L. Rev. 991 (1942), Birnbaum, *Form and Substance in Field Warehousing*, 13 Law and Contemp. Prob. 579 (1948), JACOBY AND SAULNIER, *FINANCING INVENTORY ON FIELD WAREHOUSE RECEIPTS* (1944).

¹¹⁴ Does the Sales in Bulk Law apply to field warehousing? See *infra*, n. 180.

to the warehouse company should be fenced off with wire netting. The only means of ingress and egress should be a padlocked door, the keys to which are in the exclusive possession of the warehouse company. Furthermore, in order to exhibit the open and notorious dominion of the warehouse company as an independent bailee, signs should be posted stating that the goods are stored with the warehouse company. Recording is not required, the theory being that third parties will not be misled since a sufficient change of possession has occurred. Generally a custodian of the leased premises is hired by the warehouse company. Often he is selected from among the employees of the borrower because they have an acquaintance with the handling and maintenance of the goods. He will be covered by a fidelity bond and will be put on the payroll of the warehouse company as long as the field warehouse exists.

So long as the possession of the warehouseman is open, unequivocal, and exclusive, the arrangement will be valid. The leading case on the whole subject is *Union Trust Co. v. Wilson*.¹¹⁵ Here a merchant walled off part of the basement of his store where he stored some goods and leased it to a warehouse company. The warehouse company, which alone had access to the premises, displayed signs stating that it had possession of the goods. The merchant pledged the warehouse receipts to a bank. When the merchant went into bankruptcy, the trustee in bankruptcy claimed that the goods were in the possession of the bankrupt and not the warehouse company. Mr. Justice Holmes, speaking for the Supreme Court, upheld the bank's right to the goods.

"The transfer of the receipt is not a symbolical delivery; it is a real delivery to the same extent as if the goods had been transported to another warehouse named by the pledgee. * * * When there is conscious control, the intent to exclude and the exclusion of others, with access to the place of custody as of right, there are the elements of possession in the fullest sense."¹¹⁶

"It is suggested that the goods gave credit to the owner. But, in answer to this, it is enough to say that the goods were not visible to anyone entering the shop. They could be surmised only by going to the basement, where signs gave notice of the company's possession, and probably could be seen only if the company un-

¹¹⁵ 198 U. S. 530 (1905).

¹¹⁶ *Ibid.*, 536-37.

locked the doors. There is nothing stated which warrants us in doubting that all the transactions were in good faith."¹¹⁷

There have been many cases, however, where the field warehouse arrangement was strictly a sham.¹¹⁸ Two years later, in *Security Warehousing Co. v. Hand*,¹¹⁹ the Supreme Court invalidated an arrangement whereby no signs were posted on the outside of the building, the inside signs were highly ambiguous, and the borrower had free access to the warehoused goods because the key to the segregated area was in his possession. The Supreme Court stated that failure of the warehouseman to maintain *open, exclusive, and unequivocal* possession made the arrangement a mere subterfuge which allowed the bankrupt to pledge the receipts and raise money upon secret liens on property in the possession of the pledgor.¹²⁰

The only case that has arisen in Maryland on the validity of a field warehousing plan was *In re Spanish American Cork Products Co.*¹²¹ Spanish American Cork Products Co. borrowed \$15,000 from the Western National Bank. To secure the loan, the cork company pledged "certain corkwood, disk waste, cork shavings, and stripped cork" in the following manner. The bank appointed Nichol, an employee of the cork company, as its agent. The cork company then leased to Nichol certain areas of its plant in which the pledged goods were kept. Nichol issued receipts to the bank. The pledged cork was kept apart from the

¹¹⁷ *Ibid.*, 538.

¹¹⁸ Mr. Justice Holmes stated in *Union Trust Co. v. Wilson*, *supra*, n. 115, 537, that "no doubt there are other cases in which the exclusive power of the so-called bailee gradually tapers away until we reach those in which the courts have held as a matter of law that there was no adequate bailment".

¹¹⁹ 206 U. S. 415 (1907).

¹²⁰ Counsel for a large warehouse company gives the following definition of "open, unequivocal, and exclusive possession":

"'Open Possession' means that the warehouseman must give the reasonable notice to the public that possession of the goods has been transferred by posting signs, indicating such possession in the warehouseman and by segregation of the goods. 'Unequivocal and exclusive possession' means simply that the borrower, while he may have the physical power of access to the goods, has no right to disturb or remove the goods from the warehouseman's custody, any more than any other intruder. When these conditions have been fulfilled, the fact that the motive of the borrower was to get his goods represented by a warehouse receipt for convenience of pledging is, as the Supreme Court said in the Wilson case, 'A lawful motive and did not invalidate his acts if otherwise sufficient'."

Butler, *Trust Receipts and Field Warehousing*, 42 Ill. B. J. 786, 792 (Supp., June, 1954).

¹²¹ 2 F. 2d 203 (4th Cir., 1924), *cert. den.* 266 U. S. 634 (1925).

company's other stock behind padlocked doors, the only keys to which were held by Nichol and a watchman of the cork company. On the outside of the building, there were no signs or notes indicating that a part of the premises was controlled by someone other than the cork company. On the padlocked doors inside of the building were placed large signs, "Keep Out, Property of A. E. Nichol, Agent". The name of the bank nowhere appeared on the leased premises. Nichol's actual control of the pledged cork was strictly maintained. He released cork from the segregated area only upon payments to the bank or when new cork was substituted.¹²²

When the cork company was adjudicated a bankrupt, its trustee in bankruptcy contended, and the Fourth Circuit agreed, that the bank's possession of the pledged cork was insufficient.

"All authorities agree that possession is necessary to the validity of a pledge. The necessary indication of possession varies, of course, according to the nature and bulk and situation of the property. The rule is the pledgee must either have actual exclusive possession of the property, or if it remains on the pledgor's premises he must so separate and mark it as to give notice of his possession to the public, who might deal with the pledgor on the faith of it. In this case the cork was in the building occupied by the bankrupt, engaged in the cork business. Those who dealt with it had a right to assume in the absence of notice that the stock of cork carried in the building for use in the business was the property of the company which was using it. There was nothing on the outside to put anybody on inquiry. The public dealing with the cork company or interested in it could not be required to search for notice of some other ownership of the stock of cork by making an obtrusive and prying inspection of the inside of the cork company's premises to find and inquire the meaning of signs of agency of one of the bankrupt's employees. . . . It is the duty of the pledgee to make such segregation and marks as will indicate his possession to business men of ordinary prudence dealing with the pledgor in the ordinary course of business."¹²³

¹²² The only deviation from the scheme was occasional use by the cork company of driers located in the leased portion of the plant. However, the court did not base its decision upon this relaxation.

¹²³ *Supra*, n. 121, 204.

In re Spanish American Cork Products stands for two important rules. First, notice of the warehousing arrangement should be placed on the outside of the premises so that everyone dealing with the pledgor will know the status of the goods without being required to make an "obtrusive and prying inspection". Second, the name of the warehouseman should appear on the signs. An additional factor, not mentioned by the Court, which undoubtedly influenced the decision, was the absence of an independent warehouseman. Section 58 of the Uniform Warehouse Receipts Act confines a "warehouseman" to "a person lawfully engaged in the business of storing goods for profit". This provision would seem to preclude a borrower or lender not ordinarily engaged in the storage of goods from establishing a field warehouse on the premises. A few old Maryland cases¹²⁴ seem to prohibit the issuance of warehouse receipts without an independent warehouseman. In *Washington Co. Bank v. Motter*,¹²⁵ a flour manufacturing company borrowed money from a bank and gave as security receipts stating that the company had received from the bank a certain amount of wheat, subject to the order of the bank upon the surrender of the receipts. When the company failed, the bank contended that it was entitled to priority over the general creditors because the receipts were warehouse receipts giving to their holder full title to the property. The Court of Appeals held that the milling company was not a warehouseman doing a storage business within the meaning of the statute,¹²⁶ and therefore could not pledge goods merely by issuing a receipt or certificate indicating that it held them for the bank.

In the similar case of *State v. Bryant*,¹²⁷ the Court stated that:

"[T]he Legislature never meant to declare that a mere receipt issued by one engaged in the canning business, for goods canned by him, and which were to remain in his possession, subject to the order of the purchaser, should pass title to the goods as against all other persons, . . . Such a construction would in a measure repeal the well settled law of this State, which declares that no sale of personal property of which the

¹²⁴ These cases were decided before the Uniform Warehouse Receipts Act, but apparently the pre-Uniform Act definition of warehouseman was analogous.

¹²⁵ 97 Md. 545, 55 A. 313 (1903).

¹²⁶ MD. LAWS 1876, Ch. 262, the warehouse receipts law before 1910.

¹²⁷ 63 Md. 66 (1885).

vendor remains in possession shall be valid except as between the parties, unless by a bill of sale or mortgage duly executed and recorded, . . ."¹²⁸

In other jurisdictions, field warehousing agreements have been invalidated where there were no signs or segregation of goods,¹²⁹ where a key was left beside the padlocked entrance,¹³⁰ where the borrower simply remained in possession of the leased premises,¹³¹ and where the warehouseman was an indistinguishable corporate subsidiary of the borrower.¹³²

Field warehousing is not adaptable to situations where a rapid turnover of goods is desirable. For instance, retailers generally find it necessary to remain in possession of all their goods so that they can continually be offered for sale. In addition, the nuisance of constantly substituting new inventory and keeping records on the movements of all goods may create a cumbersome deterrent; and if the strict control of the warehouseman is not obeyed, the arrangement will be invalidated by the borrower's trustee in bankruptcy.¹³³

Field warehousing does provide a good security device when the borrower's business is a seasonal one; the out-of-season goods can be warehoused without loss of sales. With goods like liquors and cheese, where maturation requires storage for several years, field warehousing will also be feasible. The prime advantage of field warehousing, as compared to other security devices, is that the lender has possession of the collateral. With a chattel mortgage, a trust receipt, or a factor's lien, the borrower remains in possession of the collateral, and the lender places substantial reliance on the borrower's honesty. Under field warehousing, the borrower's honesty scarcely enters the picture since he cannot dissipate the collateral.

¹²⁸ *Ibid.*, 70. See also *Thurber v. Oliver*, 26 Fed. 224 (D. Md., 1885).

¹²⁹ *Pittman v. Union Planters Nat. Bank & Trust Co.*, 118 F. 2d 211 (6th Cir., 1941); *American Can Co. v. Erie Preserving Co.*, 171 Fed. 540 (W. D. N. Y., 1909).

¹³⁰ *Jordan v. Federal Trust Co.*, 296 Fed. 738 (D. Mass., 1924).

¹³¹ *McGaffey Canning Co. v. Bank of America*, 109 Cal. App. 415, 294 P. 45 (1930); *People's Bank v. Aetna Indemnity Co.*, 91 Conn. 57, 98 A. 353 (1916).

¹³² *Hamilton Ridge Lumber Sales Corporation v. Wilson*, 25 F. 2d 592 (4th Cir., 1928).

¹³³ This might not detract too heavily from the merits of field warehousing, since warehousemen bond their employees and carry liability policies to give financiers added protection.

3. *The Factor's Lien*

Our tale of inventory financing concludes with the most recent device, the factor's lien.¹³⁴ The "factor" wears a coat of many colors, and in Maryland he seems to have appeared in four different guises. It is therefore of undeniable importance initially to distinguish the various meanings of "factor".¹³⁵

1. The first kind of factor was essentially a commission merchant. In the colonial period, British textile merchants, unwilling to leave England to sell their goods, often selected dependable agents in the colonies. These agents, who were called both "factors" and "commission merchants", were entrusted by their employers with goods for purposes of sale. The factor would select his own customers, make the sales, retain a stipulated commission, and forward the balance to his principal in England.¹³⁶ As the use of factors spread to domestic trade, a number of disputes over the ownership of the goods arose between principal and the bona fide purchaser from the factor. The principal would claim that the factor did not have authority to sell the goods while the purchaser would contend that the factor had been clothed with apparent authority to make sales. To protect bona fide purchasers and to facilitate commerce, a number of states, including Maryland, passed "Factor's Acts".¹³⁷ The original Maryland law, enacted in 1825,¹³⁸ stated that a factor entrusted with goods was deemed the true owner so far as to give validity to any sale or pledge of the merchandise to a person who enters into such a transaction in good faith.¹³⁹ With modifications and amendments, this Act now appears as Sections 1-16 of Article 2.

2. The next "factor" appeared in 1922 when the Maryland Legislature passed a law providing that *any agent* conducting a business other than in his own name shall file a certificate of Agency in an "Agency Record".¹⁴⁰ Although

¹³⁴ The most exhaustive discussion of the factor's lien is in Skilton, *The Factor's Lien on Merchandise*, 1955 Wis. L. Rev. 356 and 609. See also, Fechteler, *The Factor's Lien Statutes*, 74 Bank. L. J. 461 (1957).

¹³⁵ A great wave of confusion has resulted from the collection of three of these guises in 1 Md. CODE (1957), Art. 2, naively entitled, "Agents and Factors".

¹³⁶ See 2 MECHEM, AGENCY (2nd ed. 1914), §§2496-2588.

¹³⁷ See 2 WILLISTON, SALES (Rev. ed. 1948), §320.

¹³⁸ MD. LAWS 1825, Ch. 182, §§1-8.

¹³⁹ See *Miller v. Lea*, 35 Md. 396, 408 (1872). Cf. *Syriani v. Gebhart*, 195 Md. 69, 72 A. 2d 766 (1950).

¹⁴⁰ MD. LAWS 1922, Ch. 381, §§18-20. Failure to record permits a creditor of the agent to levy upon any property on the agent's premises in disregard of the principal's ownership. But see 1 Md. CODE (1957), Art. 2, §9 and *In re Eichengreen*, 18 F. 2d 191 (D. Md., 1927).

this provision does not appropriate the word "factor", it has been referred to as the "Agents and Factor's Act",¹⁴¹ apparently to distinguish it from the earlier law, which is referred to simply as "The Factor's Act".¹⁴² The Act of 1922, which now appears as Sections 18-20 of Article 2, is a piece of unique legislation. Only three other states, Virginia, West Virginia, and Mississippi, have similar laws, but the others, variously known as "Trader's Acts" or "Sign Statutes", substitute a sign on the agent's premises for the recording of the Maryland Act.¹⁴³ While the original "Factor's Acts" were aimed primarily at enlarging the power of the agent to deal with the goods in order to protect bona fide purchasers and pledgees, these Traders Acts and the Maryland Act of 1922 dealt primarily with the rights of the agent's creditors.¹⁴⁴

3. The third type of "factor" purchases accounts receivable; he was discussed in the section on accounts receivable financing.

4. Finally, the fourth factor is the subject of the Factor's Lien Act, Sections 21-29 of Article 2.¹⁴⁵ This factor is a descendant of the old commission merchant¹⁴⁶ but his functions are radically different. The new factor is a commercial banker who lends money on the security of a shifting stock of merchandise.¹⁴⁷ He retains a "continuing general lien" upon present merchandise, after-acquired merchandise, and proceeds of sales. The old "bugaboos" of chattel mortgage law disappear.

Unfortunately, the Factor's Lien Act "is a model of bad drafting".¹⁴⁸ Its language is so ambiguous that only a

¹⁴¹ See, e.g., *In re Nickulas*, 117 F. Supp. 590, 592, fn. 1 (D. Md., 1954), and *In re Sachs*, 31 F. 2d 799, 800 (D. Md., 1929).

¹⁴² See, e.g., *Syriani v. Gebhart*, 195 Md. 69, 79, 72 A. 2d 766 (1950), and *Rowland v. Dolby*, 100 Md. 272, 774, 59 A. 666 (1905).

¹⁴³ See *In re Nickulas*, 117 F. Supp. 590, 592, fn. 1 (D. Md., 1954).

¹⁴⁴ On the rights of creditors under these laws, see Note, 27 Va. L. Rev. 962 (1941). It was held in *In re Nickulas*, *supra*, n. 143, that an entruster under the Maryland Trust Receipts Act [8 Md. CODE (1957), Art. 95½] does not have to comply with the Agents and Factors Act [1 Md. CODE (1957), Art. 2].

¹⁴⁵ 1 Md. CODE (1957). The first Factors Lien Act was passed in New York in 1911. It attracted little attention until the early 1940's when many other states passed similar laws. Today over half of the states have a Factor's Lien Act. The Maryland Act was passed in 1945, Md. Laws 1945, Ch. 1019. See also Md. RULE 1393 [Factor's Lien — Foreclosure] (Tent. Draft, Sept., 1957).

¹⁴⁶ For an interesting account of the genealogy of the modern factor, see Steffen and Danziger, *The Rebirth of the Commercial Factor*, 36 Col. L. Rev. 745 (1936).

¹⁴⁷ On the purpose of the Factor's Lien Acts, see remarks by Judge Anderson in *In re Frederick Speiër Footwear Corporation*, 129 F. Supp. 434, 436-37 (D. Conn., 1955).

¹⁴⁸ Gilmore, *Chattel Security: II*, 57 Yale L. J. 761, 771 (1948).

cloistered dreamer would feel that here was the solution to all the problems of inventory financing. Yet, the legislature has spoken, and with it beckons the unceasing call for analysis, whatever the peril.¹⁴⁹

Who is eligible to become a factor under the statute? The Maryland definition is very broad:

“[P]ersons, firms, banks, and other corporations, and their successors in interest, lending or advancing or agreeing to lend or advance money on the security of merchandise, or the proceeds of sale thereof, whether or not they are employed to sell merchandise.”¹⁵⁰

Although retail merchants are ineligible by statute to borrow in some states, in Maryland anyone who owns merchandise can create a lien on that merchandise in favor of a factor, but merchandise does not include “fixtures or other trade and manufacturing equipment”.

Notice of the factoring agreement between the factor and the borrower must be recorded in a “Factors’ Liens” Book in Baltimore City or the county where the merchandise is located. This notice must be filed within fifteen days after the execution of the agreement, but no mention is made of the efficacy of filing after this fifteen day period.¹⁵¹ In addition, there is no grace period; thus, filing within fifteen days does not relate the lien back to the date of the agreement so as to defeat the rights of intervening creditors. It “shall be effective from the time of the recording thereof as against all claims of creditors of the borrower without prior liens on the merchandise”.¹⁵² The notice to be filed must include the names and addresses of both the borrower and the factor, a description of the “general char-

¹⁴⁹ It should be mentioned at this point that the Maryland Act has been mentioned in only one case, where it was cited without discussion. See *In re Harvey Distributing Co.*, 88 F. Supp. 466, 468 (E. D. Va., 1950), where the Trustee in Bankruptcy pointed out that the Maryland Factor's Lien Act was similar to the Uniform Trust Receipts Act in permitting buyers in the ordinary course of trade to take free of the lender's lien. Had the result of this case not been changed by the 1950 amendment to §60 of the Bankruptcy Act [11 U. S. C. A. §96 (1957)] there would exist a reasonable doubt as to the validity of any factor's lien. See also summaries of Referee's orders, *In re Liberty Motors and Engineering Corp.*, No. 10,012 (D. Md., 1949), 56,667 CCH BANKR. L. REP. and *In re Baltimore Castings Corp.*, No. 10,004 (D. Md., 1949), 56,677 CCH BANKR. L. REP., both dealing with the fact that under the pre-1950 test of voidable preferences, factor's liens were invalid against a trustee in bankruptcy.

¹⁵⁰ 1 M^d. CODE (1957), Art. 2, §21. It is not clear whether one who “advances money” includes one who supplies goods while deferring payment of the purchase price.

¹⁵¹ For consequences of the late filing of a chattel mortgage, see *Baltimore Credit Union v. Thorne*, 214 Md. 200, 134 A. 2d 84 (1957).

¹⁵² *Supra*, n. 150, Art. 2, §24.

acter" of the merchandise subject to the lien, and the period of time during which loans or advances are expected to be made.

Buyers in the ordinary course of trade take free of the lien if a provision to that effect is included in the factoring agreement between borrower and lender and is recorded in the "Factors' Liens" Book.¹⁵³ The theory here is the same as under the Uniform Trust Receipts Act: a buyer in the ordinary course of trade should not be required to make a search of the record offices every time he makes a purchase.¹⁵⁴

When a sale of merchandise is made to a buyer in the ordinary course of trade, the factor's lien extends to the proceeds of sale.¹⁵⁵ In Maryland, this lien on proceeds is automatic, although in some states the factor must perform some further act to perfect his lien.¹⁵⁶ But alas, all the problems that were encountered with the entruster's lien on proceeds under the Uniform Trust Receipts Act reappear.¹⁵⁷ The lack of cases and the sterility of statutory mandate make it impossible to chart any definite legal rules on factors' liens on these proceeds.¹⁵⁸ And once again the spectre of *Benedict v. Ratner*^{158a} lurks at the nearest corner. The conspicuous silence of the Maryland Factor's Lien Act on this problem of requiring prompt application of proceeds to the debt will probably lead cautious lenders scrupulously to police the borrower's accounts.¹⁵⁹

After-Acquired Property Clause. One of the important innovations of the Factor's Lien Act [1 MD. CODE (1957), Art. 2] is the provision that the lien may cover after-

¹⁵³ *Ibid.*, §§23, 24. The Act does not state whether a subsequent mortgagee, pledgee, or entruster under the UTRA cuts off the lien.

¹⁵⁴ Also protected by the Factor's Lien Act are subsequent liens of dyers, mechanics, artisans, processors and landlords. *Ibid.*, §24.

¹⁵⁵ Only if such a provision is included in the factoring agreement and is recorded. *Ibid.*

¹⁵⁶ Some of the states require the factor to notify the account debtor that the proceeds are to be paid to him; others require the factor to record the assignment of proceeds; and a third group requires the borrower to execute a separate assignment of the proceeds to the lender. See articles cited, *supra*, n. 134.

¹⁵⁷ See *supra*, text at ns. 96-99.

¹⁵⁸ See Skilton, *The Factor's Lien on Merchandise* — Part II, 1955 Wis. L. Rev. 609, 637-45.

^{158a} 268 U. S. 353 (1925).

¹⁵⁹ See *Colbath v. Mechanics Nat. Bank of Concord*, 96 N. H. 110, 70 A. 2d 608 (1950), holding, *inter alia*, that failure to account for the proceeds does not invalidate the lien. But see *Manchester Nat. Bank v. Roche*, 186 F. 2d 827 (1st Cir., 1951), *affmg.* In re Standard Const. Co., 92 F. Supp. 838 (D. N. H., 1950). Although many other states provide for liens on accounts receivable, the Maryland Factor's Lien Act does not even mention this very important problem.

acquired merchandise. However, Section 22 may seriously limit the scope of this lien:

"If so provided by any written agreement with the borrower, a factor shall have a continuing general lien upon all merchandise described in such agreement or memoranda thereof, or if so provided in said agreement, all merchandise from time to time designated in separate written statements, dated, signed and delivered by the borrower to the factor, . . . whether or not such merchandise is in the constructive, actual, or exclusive occupancy or possession of the factor, . . ."

This language apparently means that future-acquired goods will not be subject to the factor's lien until the borrower executes separate statements covering his new acquisitions and delivers these statements to the factor. In other words, as each piece of new inventory comes into the borrower's possession, he must go through the time-consuming procedure of executing statements designating the acquisition.¹⁶⁰

One writer suggests that perhaps the mere execution of *periodic* statements covering expected deliveries for a limited future period is sufficient under the Factor's Lien Act and would therefore obviate the inconvenience of executing a new statement whenever new merchandise is acquired.¹⁶¹ One could also point to the following provision of the Maryland Act:

"This sub-title is to be construed liberally to secure the beneficial interest and purposes thereof. A substantial compliance with its several provisions shall be sufficient for the validity of a lien. . . ."¹⁶²

Yet the dictates of caution will compel most lenders to comply with the literal mandate of the Act rather than rely on this nefarious canon of statutory construction.

Statutes in several other states omit the Maryland requirement of separate statements for new acquisitions. New York and New Hampshire, for instance, provide that factors have a "continuing general lien upon all goods and merchandise from time to time *consigned to or pledged*

¹⁶⁰ This provision is, of course, a next of kin to the requirement of the Trust Receipts Act that the entruster's lien on specific goods is perfected only when the trustee executes a separate trust receipt on those goods. See *supra*, text, *circa*, n. 85.

¹⁶¹ See Weeks, "Floating Liens" in *Inventory Financing*, 1956 Univ. of Ill. L. Forum 557, 570-72.

¹⁶² 1 MD. CODE (1957), Art. 2, §28. Liberally construed for whom?

with them".¹⁶³ Decisions under this type of law hold that the necessary "consigning or pledging" is accomplished by the master factoring agreement, which covers subsequent acquisition of property by the borrower.¹⁶⁴ Moreover, even if the master factoring agreement provides for the execution of periodic listings of acquisitions, "this seems a mere administrative provision for the benefit of" the factor of which no one else may take advantage.¹⁶⁵

The New York-New Hampshire rule is desirable¹⁶⁶ in the sense that the great nuisance of executing many documents is eliminated.¹⁶⁷ These documents are of no value to creditors who presumably have received notice from the Factors' Liens Book of the existence of a "continuing general lien". To the argument that separate documents will help identify the goods if the borrower fails, it may be said that goods like raw materials lose their identifiable characteristics as they are transformed into finished products so that the factor would be unable to identify them even with the designating documents.¹⁶⁸

The New York-New Hampshire rule is also more desirable when the impact of Section 60 of the Bankruptcy Act on factors' liens is considered. The preference difficulty occurs when the factor desires to subject to his lien the after-acquired property of the borrower. If this property is acquired within four months of bankruptcy, and if the borrower was insolvent and the factor knew or had good reason to believe that the borrower was insolvent, the elements of a voidable preference are present. The problems arise if the factor claims that his lien was perfected at the time of the original agreement (i.e., before the four month period), and not at the time the borrower acquired the property. This argument of the factor is persuasive

¹⁶³ N. Y. PERSONAL PROPERTY LAW (1951), §45; 4 N. H. REV. STAT. ANN. (1955), §446.2. Emphasis added.

¹⁶⁴ See *In re Comet Textile Co.*, 15 F. Supp. 963 (S. D. N. Y. 1936), *affd.* 91 F. 2d 1008 (2d Cir., 1937); *Colbath v. Mechanics National Bank*, 96 N. H. 110, 70 A. 2d 608 (1950).

¹⁶⁵ *Colbath v. Mechanics National Bank*, *ibid.*, 610. For a different result under New Hampshire law with respect to future accounts receivable, see *Manchester Nat. Bank v. Roche*, 126 F. 2d 827 (1st Cir., 1951). In 1951, New Hampshire erased the effect of this case by amending their Factors' Lien Law. N. H. REV. STAT. ANN. (1955), §446:7.

¹⁶⁶ See also *infra*, text at ns. 169-171.

¹⁶⁷ "It seems improbable that our Legislature intended that a general store borrower, for example, must separately consign each spool of thread, can of beans or package of gum to a lender bank in order to maintain the lien." *Colbath v. Mechanics National Bank*, 96 N. H. 110, 70 A. 2d 608, 610 (1950).

¹⁶⁸ Nevertheless, the Maryland rule does possess the healthy feature of requiring the factor to maintain some supervision over his borrower.

under the New York-New Hampshire type of statute,¹⁶⁹ but under the Maryland statute, the factor's lien attaches to after-acquired property only when the borrower executes a statement designating the goods that have come into his possession. If this statement is delivered to the factor within four months of the petition, and if the other elements of a voidable preference are satisfied, it would seem that the trustee in bankruptcy could successfully attack the lien.¹⁷⁰ Since the policy of the Maryland Factor's Lien Act is presumably to encourage factoring, amendment of the Act along the lines of the New York-New Hampshire provision would be salutary as protection against this probable onslaught of Section 60 of the Bankruptcy Act.¹⁷¹

Above all, the Maryland type of factor's lien represents only a slight improvement over the trust receipt.¹⁷² As we have seen, the trust receipt could effectively be used only

¹⁶⁹ See *Manchester Nat. Bank v. Roche*, 186 F. 2d 827 (1st Cir., 1951), where Judge Magruder maintained that the lien of the factor on inventory is a lien on a floating mass — "a mass whose entity continues, though specific items come and go". Skilton, *The Factor's Lien on Merchandise — Part II*, 1955 Wis. L. Rev. 609, 646. This "entity theory", as Skilton calls it, would answer the charge of voidable preference as to items received within four months of bankruptcy. Judge Magruder states, p. 831, that:

"[T]he New Hampshire legislature specifically provided that the lien on merchandise would be valid from the time of filing the prescribed notice 'whether such merchandise shall be in existence at the time of the agreement creating the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower.' In other words, the *res* which is the subject of the lien . . . is the merchandise or stock in trade, conceived of as a unit presently and continuously in existence — a 'floating mass', the component elements of which may be constantly changing without affecting the identity of the *res*."

At this point Judge Magruder cited a Maryland case, *Hopkins v. Baker*, 78 Md. 363, 28 A. 284 (1894), which held that the stock in trade of a partnership constituted "goods and chattels *permanently* located" within the provision of a taxing statute. "The articles are changing from day to day, but the stock, which represent the aggregate of the goods and chattels, remains about the same." *Ibid.*, 372.

¹⁷⁰ See *Irving Trust Co. v. Commercial Factors Corporation*, 68 F. 2d 864 (2d Cir., 1934), holding that the basic factoring agreement is not an immediate transfer of a future interest, and that therefore the attachment of a factor's lien to goods acquired by the borrower within the four months period constituted a voidable preference. This is the likely result under Maryland law, although the above case has been rejected under the different New York and New Hampshire statutes. In re *Comet Textile Co.*, 15 F. Supp. 963 (S. D. N. Y., 1936), *affd.* 91 F. 2d 1008 (2d Cir., 1937), and *Colbath v. Mechanics National Bank*, 96 N. H. 110, 70 A. 2d 608 (1950).

¹⁷¹ Also relevant are the tricky provisions of the "equitable lien" section of the Bankruptcy Act — §60(a)(6) [11 U. S. C. A. §96 (1957)]. See *Porter v. Searle*, 228 F. 2d 748 (10th Cir., 1955) and Comment, *The 1950 Bankruptcy Amendment and Equitable Liens in Historical Context — Strict v. Liberal Interpretation of Section 60(a)(6)*, 50 N. W. U. L. Rev. 541 (1955).

¹⁷² It is true that one advantage of a factor's lien is that a merchant can borrow on the security of goods already in his possession, while this is impossible under a trust receipt. See *supra*, n. 102.

if a separate trust receipt were executed for each shipment of goods received. If the Factor's Lien Act requires designation of each new acquisition, we have revived the great demerit of the trust receipt. A lien on a shifting stock of many items can be workable only if the parties dispense with multitudinous documents; only if the lien attaches automatically by virtue of the execution of the initial financing agreement will the goal be reached.

*Applicability of the Sales in Bulk Act.*¹⁷³ Finally, it is necessary to discuss the important question of whether the Sales in Bulk Act applies to factors' lien. Bulk Sales laws were passed by every state as a result of the dissatisfaction with a defect in the law of fraudulent conveyances. In the situation where a merchant suddenly disposed of his entire stock and absconded with the proceeds, it often could not be proved that the purchaser of the stock had a fraudulent intent even though there was clearly fraud on the part of the seller.¹⁷⁴ In 1900, Maryland passed a Sales in Bulk Law,¹⁷⁵ and the present form of the statute was codified in 1927.¹⁷⁶

The Maryland statute provides that a sale of a stock of goods, wares, or merchandise except in the ordinary course of trade shall be void as against creditors of the seller, unless (i) the parties prepare a detailed inventory and verified list of creditors, (ii) the creditors are given ten days' notice of the proposed sale, along with the price, terms, and conditions of the sale, and (3) the purchaser is required to see that the proceeds of the sale are applied to the claims of the seller's creditors. If the transaction is void by reason of this Act, the purchaser is accountable to the creditors as a receiver of the goods.¹⁷⁷

¹⁷³ 7 MD. CODE (1957), Art. 83, §§97-101. On Bulk Sales Acts, see an exhaustive analysis in three articles by Miller in 1954 Wash. U. L. Q. 1, 132 and 283.

¹⁷⁴ See 3 WILLISTON, SALES (Rev. ed. 1948), §639; Billig, *Bulk Sales Laws: A Study in Economic Adjustment*, 77 Univ. of Pa. L. Rev. 72 (1928).

¹⁷⁵ MD. LAWS 1900, Ch. 579.

¹⁷⁶ MD. LAWS 1927, Ch. 534. There were some rather important changes made in the years between 1900 and 1927. Under the old act, non-compliance created only a rebuttable presumption of fraud. *Hart v. Roney*, 93 Md. 432, 49 A. 661 (1901). The newer act simply declared that non-compliance "shall be fraudulent and void", (§98), apparently creating a conclusive presumption. The newer act also substituted ten days notice for five days notice, and set out in full the affidavit to be executed by the seller (§97).

¹⁷⁷ It has been contended that the Bulk Sales Acts do not afford adequate protection to creditors. See good article by Weintraub and Levin, *Bulk Sales Law and Adequate Protection of Creditors*, 65 Harv. L. Rev. 418 (1952). Those dealing with the Maryland Act must also reckon with the sales tax implications, 7 MD. CODE (1957), Art. 81, §§353-56, and the permit requirement for the bulk sale of an alcoholic beverage establishment, *ibid*,

For present purposes, our inquiry is limited to determining whether a factor who is obtaining a lien on his borrower's merchandise must also comply with the bulk sales law. The only reported case that has dealt with this problem is a New Hampshire decision holding that the Bulk Sales Act does not apply to factors' liens.¹⁷⁸ The analogous situation of the applicability of the Sales in Bulk Act to chattel mortgages has arisen several times, and most courts have held these acts inapplicable.¹⁷⁹ Several theories have induced this result. First, a "sale" contemplates a complete change of title, whereas a chattel mortgage only conveys a limited property interest. Second, the Bulk Sales Acts are only directed at transactions where possession of the goods changes hands. Both of these considerations also apply to factors' liens, and consequently it is probable that the Maryland Sales in Bulk Act will not affect factors' liens.¹⁸⁰

There is also a delightfully ambiguous provision in the Maryland Factors' Lien Act which may settle the issue:

"[A]s to any transaction falling within the provisions both of this subtitle and of any other statute of this State requiring or permitting filing, recording, consent, publication, notices or formalities of execution, the factor shall not be required to comply with the provisions of any such other statute."¹⁸¹

Does the "notice" referred to denote only public notice or does it also denote private notices to creditors of the bor-

Art. 2B, §4(b)(4). There has been very little case law in Maryland on the Bulk Sales Act. *Baumohl v. Columbia Jewelry Co.*, 209 Md. 278, 120 A. 2d 830 (1956) and *F. & D. Co. of Md. v. Thomas*, 133 Md. 270, 105 A. 174 (1918) construe the meaning of "creditors" for whose protection the Act was passed. *Calvert Bldg. & Const. Co. v. Winakur*, 154 Md. 519, 141 A. 355 (1928) and *Sakelos v. Hutchinson Bros.*, 129 Md. 300, 99 A. 357 (1916), illustrate types of property whose transfer comes within the Act.

¹⁷⁸ *Colbath v. Mechanicks National Bank*, 96 N. H. 110, 70 A. 2d 608, 609 (1950).

¹⁷⁹ See Billig and Smith, *Bulk Sales Laws: Transactions Covered by These Statutes*, 39 W. Va. L. Q. 323 (1933); Annotations, 57 A. L. R. 1049, 14 A. L. R. 753, 9 A. L. R. 473.

¹⁸⁰ See *Barry v. Lawrence Warehouse Co.*, 190 F. 2d 433 (9th Cir., 1951), where the court held that field warehousing did not violate the Arizona Bulk Sales Act. See also *Heffron v. Bank of America Nat. Trust & Savings Ass'n.*, 113 F. 2d 239 (9th Cir., 1940), where the court reached the same result under the California Bulk Sales Act because the California Act expressly repealed all acts or parts of acts that might otherwise deal with warehoused goods. In Arizona and Maryland, it is significant that the section of the Uniform Warehouse Receipts Act repealing inconsistent legislation was not enacted.

¹⁸¹ 1 Md. CODE (1957), Art. 2, §28. New Hampshire, which has held that the Bulk Sales Act does not apply to factor's liens, has a provision similar to that of Maryland. See 4 N. H. REV. STAT. ANN. (1955), §446:10.

rower under the Sales in Bulk Law? A strong argument can be made for requiring factors to comply with the Sales in Bulk Law. From the point of view of existing creditors, there is little difference between a dishonest debtor's *selling* all of his property and *encumbering* all of his property.

The possibility of fraud justifies the need for compliance by factors with the Sales in Bulk Act. On the other hand, to require full payment of the borrower's creditors according to the provisions of the Sales in Bulk Act may leave to the borrower very little of the loan.

CONCLUSION

It should be clear that the crying need in this field is for well-drafted legislation. Loopholes, ambiguities, inconsistencies, and enigmas are unmistakably the trademarks of the present statutes. Many of the Maryland statutes are nothing more than slavish imitations of the bad laws of other jurisdictions. The multitude of devices — chattel mortgages, trust receipts, factors' liens, and warehousing — that may be used for inventory financing only serves to confuse the central issues. The proliferation of record books — in Maryland, we have a chattel mortgage book, a credit lien book, a trust receipts book, an "agency" docket, and a factors' lien book — serves no purpose other than the harassment of creditors and law students.

Article 9 of the Uniform Commercial Code represents the most comprehensive and intelligent analysis of the problems of inventory and accounts receivable financing. Although it may be a truism that no legislation can be perfect, Article 9 is undoubtedly a long step forward out of the serpentine abyss that plagues us today. The bar and the business community of Maryland should give it careful and sympathetic consideration.¹⁸²

¹⁸² The Uniform Commercial Code has been adopted in Pennsylvania, Massachusetts, and Kentucky; in 1959, it will be introduced in at least fourteen state legislatures: Connecticut, Maine, New Hampshire, Vermont, Ohio, Indiana, Illinois, Michigan, North Dakota, Colorado, Nevada, New Mexico, Utah, and Georgia; see Schnader, *The New Movement Toward Uniformity in Commercial Law — The Uniform Commercial Code Marches On*, 13 Business Lawyer 646 (1958).